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Page 1 of * 89	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2019 - * 027	Amendment No. (req. for Amendments *)
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Filing by Financial Industry Regulatory Authority
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
Section 3C(b)(2) * <input type="checkbox"/>	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Amend FINRA Rule 12000 Series to Expand Options Available to Customers if a Firm or Associated Person is or Becomes Inactive

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Mignon Last Name * McLemore

Title * Assistant General Counsel

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Telephone * (202) 728-8151 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 11/05/2019 Senior Vice President and Deputy General Counsel

By Patrice Gliniecki

Patrice Gliniecki,

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code” or “Code”) to expand a customer’s options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration. In addition, the proposed amendments would allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees in these situations.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

¹ 15 U.S.C. 78s(b)(1).

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Background

Most unpaid customer arbitration awards are rendered against firms or individuals whose FINRA registration has been terminated, suspended, cancelled, or revoked, or who have been expelled from FINRA. These firms and individuals are generally referred to as “inactive,” and are no longer FINRA members or associated with a FINRA member, although they may continue to operate in another area of the financial services industry where FINRA registration is not required. Firms and individuals can become inactive prior to an arbitration claim being filed, during an arbitration proceeding, or subsequent to an arbitration award, and this status can be caused by FINRA’s action, such as when a firm or individual is suspended for failing to pay an award, or by the firm’s or individual’s own voluntary action.

FINRA has implemented a number of changes to its arbitration program that expand the options available to a customer when dealing with those members or associated persons that are inactive either at the time the claim is filed or at the time of the award. For example, when a customer claimant first files an arbitration claim, FINRA alerts, by letter, the customer claimant if the respondent, whether a member or an associated person, is inactive. FINRA also informs the claimant that awards against such members or associated persons have a much higher incidence of non-payment and that FINRA has limited disciplinary leverage over inactive members or associated persons that fail to pay arbitration awards. Thus, the customer knows before pursuing the claim in arbitration that collection of an award may be more difficult. In addition, upon

learning that the member or associated person is inactive, a customer may determine to amend his or her claim to add other respondents from whom the customer may be able to collect should the claim go to award.

Proposed Rule Change

FINRA is proposing to amend the Customer Code² to expand further the options available to customers in situations where a firm becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. FINRA is also proposing to amend the Code to allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees if the customer withdraws the claim under these situations.³

A. Arbitrating Claims Against Inactive Members and Associated Persons

Currently, under FINRA Rule 12202 (Claims Against Inactive Members), a customer's claim against a firm whose membership is terminated, suspended, cancelled or revoked, or that has been expelled from FINRA, or that is otherwise defunct, is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises. In these situations, the customer is able to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute

² While unpaid awards occur in intra-industry cases (i.e., disputes between or among members and associated persons), the proposed amendments would apply to customer cases only.

³ FINRA is also proposing to amend the Code to update cross-references and make other non-substantive, technical changes to rules impacted by the proposed rule change.

arbitration agreement.⁴ Accordingly, claims against inactive firms proceed in arbitration only at the customer's option.

The Code does not address situations, however, where a member firm becomes inactive during a pending arbitration. In addition, the Code does not provide specific procedures for a customer to withdraw, and file in court, a claim against an associated person who becomes inactive before the customer files a claim or during a pending arbitration.

Accordingly, FINRA is proposing to amend FINRA Rule 12202 to expand a customer's option to withdraw a claim to situations where a member becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. Under the proposal, FINRA Rule 12202 would specify that a customer's claim against an associated person who is inactive at the time the claim is filed is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises. In addition, FINRA Rule 12202 would specify that if a member or an associated person becomes inactive during a pending arbitration, FINRA would notify the customer of the status change, and provide the customer with 60 days to withdraw the claim(s) with or without prejudice.⁵

⁴ If the customer notifies FINRA in writing that he or she does not want to proceed against the inactive member in FINRA's forum, FINRA deems the customer's agreement to submit to arbitration rescinded and sends the customer a full refund of any filing fee remitted.

⁵ FINRA Rule 12702 (Withdrawal of Claims) provides that before a party answers a statement of claim, the claimant can withdraw the claim with or without prejudice. However, after a party submits an answer, the claimant can only withdraw the claim with prejudice unless the panel or the parties agree otherwise. FINRA is proposing to make a conforming change to FINRA Rule 12702 to

Similar to the current rules and procedures relating to claims filed against inactive members, the proposed amendments would allow the customer to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.

In addition, FINRA is proposing to amend FINRA Rule 12100 (Definitions) to add definitions of “inactive member” and “inactive associated person.” Consistent with current Rule 12202, FINRA is proposing to define an “inactive member” as a member whose membership is terminated, suspended, cancelled or revoked; that has been expelled or barred⁶ from FINRA, or that is otherwise defunct.⁷

An “inactive associated person” would be defined as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA,⁸ or whose registration has been terminated for a minimum of 365

provide that a customer can withdraw a claim without prejudice if the party that submitted an answer is an inactive member or inactive associated person. Withdrawal without prejudice would allow the customer to re-file the arbitration at a later date.

⁶ FINRA is adding “or barred” to the definition of an “inactive member” to capture that a member may be inactive due to a bar.

⁷ The proposed rule change would amend the definition of “member” under the Customer Code, the Code of Arbitration Procedure for Industry Disputes (“Industry Code”), and in Article I of the By-Laws of FINRA Regulation, Inc. to conform the definition to the proposed definition of an “inactive member” as discussed below. The proposed changes would make the definition of “member” consistent in the FINRA rules that apply to FINRA’s arbitration forum.

⁸ In Regulatory Notice 17-33 (October 2017), discussed infra, FINRA proposed to define an “inactive associated person” as a person associated with a member whose registration is revoked or suspended, or whose registration has been

days. Thus, if an associated person's registration is not revoked, cancelled, or suspended, the person has not been expelled or barred from FINRA, and the individual's registration has been terminated for less than one year, the individual would not be classified as terminated and, therefore, would not be deemed inactive.

FINRA believes the 365-day minimum termination⁹ requirement for associated persons would help ensure that enough time has elapsed to assume reasonably that the associated person has permanently left the securities industry. The requirement would allow enough time for those associated persons who may have temporarily left the industry to return before the arbitration closes.¹⁰

B. Amending Pleadings

FINRA Rule 12309 (Amending Pleadings) limits a party's ability to amend a statement of claim, among other pleadings, after FINRA has appointed a panel to the case. Specifically, once FINRA appoints a panel to a case, a party can amend a pleading only if the arbitrators grant a party's motion to do so. FINRA Rule 12309 also provides that a party cannot add a new party to the case after arbitrator ranking lists are due to the

terminated for a minimum of 365 days. FINRA is proposing to add "expelled or barred from FINRA" and "whose registration is cancelled" to this definition to capture other ways in which an individual could be categorized as inactive.

⁹ Termination, in some cases, may be a voluntary action that can be of short duration.

¹⁰ In its analysis of 2,054 customer cases closed by hearing, on the papers, or by stipulated award from 2014 to 2018, FINRA identified 78 cases where an associated person was not in the industry while the arbitration was pending but returned to the industry in fewer than 365 days.

Director of Arbitration until FINRA appoints the panel and the arbitrators grant a party's motion to add the new party.

FINRA believes that a customer should be able to change his or her litigation strategy during a pending case once the customer learns that a firm or an associated person has become inactive. Accordingly, FINRA is proposing to amend FINRA Rule 12309 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive during a pending arbitration, the customer may amend a pleading, including adding a new party, within 60 days of receiving such notice.¹¹

C. Postponing Hearings

FINRA Rule 12601 (Postponement of Hearings) addresses when a scheduled hearing date can be postponed. The parties can agree to postpone a hearing. Absent an agreed upon postponement, a hearing can be postponed by FINRA in extraordinary circumstances, by the arbitrators at their discretion, or by the arbitrators upon a party's motion. FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, the customer may postpone the hearing date. Since the proposed amendment would provide a customer with 60 days to determine how to proceed after FINRA

¹¹ FINRA Rule 12309(d) would permit any party to file a response to an amended pleading, provided the response is filed and served within 20 days of receipt of the amended pleading, unless the panel determines otherwise. Thus, the newly-added party could file a response to the amended pleading for the panel or arbitrator to consider.

notifies the customer of the status change to inactive, it would be appropriate to allow the customer to postpone a scheduled hearing that falls within that time period.

In addition, FINRA assesses postponement fees against the parties for each postponement agreed to by the parties, or granted upon the request of one or more parties. FINRA also charges an additional fee of \$600 per arbitrator if a postponement takes place within 10 days of a scheduled hearing date. The additional \$600 per arbitrator fee is paid to the arbitrators to compensate them for the late adjournment.¹² FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, FINRA would not charge the customer a postponement fee or an additional fee of \$600 per arbitrator if a customer chooses to postpone a scheduled hearing.

FINRA is also proposing to amend FINRA Rule 12214 to make it clear that it would continue to pay the \$600 honoraria to the arbitrators to compensate them for their time if a customer chooses to postpone a scheduled hearing within 10 days before it is scheduled because the customer learns that the firm or associated person has become inactive.

D. Default Proceedings

FINRA Rule 12801 (Default Proceedings) permits a claimant to request default proceedings against any respondent whose registration is terminated, revoked or

¹² See FINRA Rule 12214 (Payment of Arbitrators).

suspended, and who failed to file an answer¹³ to a claim within the time provided in the Code. A single arbitrator will decide the case based on the claimant's pleadings and other documentation.¹⁴ The claimants must present a sufficient basis to support the making of an award.¹⁵ The arbitrator may not issue an award based solely on the nonappearance of a party.¹⁶

As noted, the proposed amendments would define an inactive associated person as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA, or whose registration has been terminated for a minimum of 365 days. In the context of a default proceeding, FINRA believes that it would be appropriate to continue to allow a customer to request default proceedings against any terminated associated person who fails to answer a claim, regardless of how long the associated person has been terminated, consistent with the existing rule. Accordingly, FINRA is proposing to amend FINRA Rule 12801(a) to specify that a claimant may request a default proceeding against a terminated associated

¹³ A respondent must serve each party with a signed and dated Submission Agreement and answer specifying the relevant facts and available defenses to the statement of claim within 45 days of receipt of the statement of claim. See FINRA Rule 12303(a).

¹⁴ See FINRA Rule 12801(b)(2)(B). No hearings are held in default proceedings unless the customer requests one. See FINRA Rule 12801(c).

¹⁵ See FINRA Rule 12801(e)(1).

¹⁶ Id. If the defaulting respondent files an answer before an award has been issued, the proceedings against this respondent will be terminated and the claim will proceed under the regular provisions of the Code. See FINRA Rule 12801(f).

person who fails to file an answer within the time provided in the Code regardless of the number of days since termination.¹⁷

E. Refunding Filing Fees

FINRA Rule 12900 (Fees Due When a Claim is Filed) specifies that if a claim is settled or withdrawn more than 10 days before the date that the hearing is scheduled to begin, a party paying a filing fee will receive a partial refund of the filing fee. The rule also provides that FINRA will not refund any portion of the filing fee if a claim is settled or withdrawn within 10 days of the date that the hearing is scheduled to begin.

FINRA is proposing to amend FINRA Rule 12900 to provide that FINRA would refund a customer's full filing fee if FINRA notifies a customer that a firm or an associated person has become inactive during a pending arbitration, and the customer withdraws the case against all parties within 60 days of the notification. FINRA would refund the filing fee even if the customer withdraws the case within 10 days of the date that the hearing is scheduled to begin.

F. Non-substantive changes

In addition to amending FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 to expand a customer's options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration, FINRA is also proposing to amend the Code to update cross-references and make other non-substantive, technical changes to the rules impacted by the proposal.

¹⁷ See supra note 9.

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁸ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed rule change would protect investors and the public interest by expanding the options available to customers with claims against respondents who are unlikely to be able to pay. The proposed rule change would extend the concept of what it means to be inactive to include associated persons expressly, so that customers would have the same options during a case against inactive associated persons as they would against inactive members. The proposed change, therefore, would add consistency to FINRA rules.

Further, FINRA believes that the proposed amendments would provide customers with expanded options and flexibility to change case strategy if FINRA notifies them that a member or associated person has become inactive during a pending arbitration. In

¹⁸ 15 U.S.C. 78q-3(b)(6).

particular, the proposed rule change would permit a customer to amend his or her pleading or to add parties without arbitrator intervention. FINRA rules, however, permit the newly-added party to respond to the amended pleading and to have the panel or arbitrator consider any objections.

The proposed rule change would also clarify the default rule to include an inactive associated person who does not answer a claim, regardless of the number of days since termination. FINRA believes that the proposed rule change would add consistency to FINRA's default rule so that the procedures would apply to inactive members and inactive associated persons equally. As a result, investors would know that they have the same options and rights in default proceedings against any inactive respondent under the Customer Code. FINRA believes this could help expedite these arbitration cases, as any ambiguity about how the rule should be applied would be removed. Moreover, FINRA believes that exempting the minimum-day termination requirement would prevent an associated person from using the 365-day requirement as a shield to delay the arbitration case.

FINRA believes that the proposed amendments provide customers with more options and flexibility in how they choose to resolve claims against respondents who are unlikely to pay, and, thus, give them more control over the arbitration case when they are notified that a member or associated person has become inactive. Moreover, by eliminating the postponement fees and refunding filing fees in certain circumstances, the proposed amendments eliminate these costs as a potential barrier for customers who may opt to pursue their claims in other forums. For these reasons, FINRA believes that the proposed rule change protects investors and the public interest.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed amendments will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. A discussion of the economic impacts of the proposed amendments follows.

Economic Impact Assessment

(a) Regulatory Need

The Code addresses situations where customers bring claims against inactive members. The Code does not address situations, however, where a member firm becomes inactive during a pending arbitration or where an associated person becomes inactive before a claim is filed or during a pending arbitration. This may limit the options available to customers to seek redress, as well as their ability to collect an award.

(b) Economic Baseline

The economic baseline for the proposed amendments is the current rules under the Code that address customer disputes in arbitration. The proposed amendments are expected to affect the parties to an arbitration, including customers, member firms, associated persons, and arbitrators.

FINRA is able to identify 2,054 customer cases closed by hearing, on the papers, or by stipulated award from 2014 to 2018. Among these cases, FINRA is able to identify 128 cases (six percent) where a member firm would have been defined as inactive (under the proposed amendments) before an arbitration. In these instances, the current rules under the Code provide customers the option to proceed in arbitration, to file the claim in court, or to take no action regardless of whether the customer signed a pre-dispute

arbitration agreement. Customers are therefore able to evaluate the likelihood of collecting on an award and to choose the forum in which to proceed.

FINRA is also able to identify 427 cases (21 percent of 2,054) where a firm became inactive during a pending arbitration, or where an associated person would have been identified as inactive (under the proposed amendments) either before or during a pending arbitration. The current rules do not provide similar options to customers in these instances, and customers may be less able to choose the forum in which to proceed or to change their litigation strategy during a pending case.¹⁹

(c) Economic Impact

The proposed amendments would expand customers' options under the Code where a member becomes inactive during a pending arbitration or where an associated person becomes inactive before a claim is filed or during a pending arbitration. The benefits and costs of the proposed amendments are discussed below.

In general, the benefits of the proposed amendments arise from the expansion of customer options under the Code when a member becomes inactive during a pending arbitration, or when an associated person becomes inactive before a claim is filed or during a pending arbitration. In these instances, the proposed amendments would

¹⁹ In the 427 cases, the total amount of compensatory damages sought by customers was \$580.3 million, and customers were awarded compensatory damages of \$96.0 million. For the 347 cases that closed from 2014 through 2017, 126 relate to an award that went unpaid, and the member firms or associated persons responsible for the unpaid awards would have been identified as inactive under the proposed amendments. The total amount of awards relating to these cases that went unpaid was \$55.9 million. The respondents that would have been identified as inactive were responsible for nearly all of the awards that went unpaid.

increase the flexibility of customers to determine whether and how to proceed in arbitration. Customers would exercise the options under the proposed amendments if they believe it would increase their ability to seek redress, and may increase the amount of monetary compensation they expect to receive.

The expansion of customer options under the Code would arise from the reduction of the restrictions and penalties to alter their litigation strategy in arbitration or to withdraw their claims from arbitration. For example, customers who proceed in arbitration may amend a pleading without arbitrators granting the motion. This includes the addition of a new respondent from whom the customer may be able to collect should the claim go to award. Customers who proceed in arbitration may also postpone a scheduled hearing without penalty to assess the options and gain additional time to prepare.²⁰ Customers may also withdraw their claim without prejudice if the party that submitted an answer is an inactive member or inactive associated person. Customers who withdraw their claims against all parties within the allotted time would also receive a full refund of the filing fee.

Customers who exercise the options under the proposed amendments, and the member firms and associated persons who are also parties to the arbitration, may incur additional costs. For example, if customers withdraw their claims from arbitration and

²⁰ Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 240 (12 percent) cases where a member or an associated person would have been identified as inactive after arbitrator ranking lists were due or FINRA appointed a panel. FINRA is also able to identify 119 (six percent) cases where a member or an associated person would have been identified as inactive within 60 days of a scheduled hearing.

restart the case in another venue, then the parties may incur additional legal expense and time to resolve the dispute. If instead customers amend their pleadings but remain in arbitration, the parties (including member firms and associated persons who are newly-named in the amended pleadings) may also incur additional legal expense to alter their litigation strategy, time to resolve the dispute, and forum fees (e.g., hearing session fees).²¹ Parties may also incur additional time to resolve the dispute if customers postpone scheduled hearings. Customers have the option to incur these additional expenses, and would likely incur them only if they believe the costs would increase the amount of monetary compensation they may expect to receive.

The proposed amendments would provide no significant benefits and impose no material costs on customers who would not change their behavior when notified of an associated person's or firm's change of status during arbitration in the presence of the amendments, nor on the members and associated persons who are party to their claims. In FINRA's experience, customers typically proceed in arbitration when notified that a member is inactive at the time of filing, and typically remain in arbitration when a member or an associated person leaves the industry while the arbitration is pending.²² One reason customers remain in arbitration when a member or an associated person leaves the industry may be the additional costs of restarting a case in another venue.

²¹ FINRA does not believe, however, that the proposed amendments would cause member firms and associated persons to be named without having a connection to the case. See discussion in Section 5.

²² Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 297 (14 percent) cases where a member firm or an associated person would have been identified as inactive during a pending arbitration.

Another reason may be the expectation that another forum would not result in a higher likelihood of redress.

Based on this experience, FINRA believes that few customers would withdraw claims from the forum in the presence of the proposed rules, but would instead remain in arbitration. Customers are, therefore, more likely to exercise their new options under the proposed amendments to amend pleadings or to postpone hearings. The benefits and costs of the proposed amendments, therefore, may result more from the amendment of pleadings or the rescheduling of hearings than the withdrawal of claims.

(d) Alternatives Considered

FINRA exercised discretion in setting the minimum number of days for a terminated associated person to be considered inactive (365). FINRA also exercised discretion when setting the maximum number of days for customers to exercise the options under the proposed amendments after they receive notification of the inactive status of a member or an associated person (60).

The minimum-day requirement for a terminated associated person to be considered inactive affects the length of time that customers must wait before being able to exercise the options under the proposed amendments. A longer minimum-day requirement decreases the number of customers who may have access to the options under the proposed amendments, and therefore decreases their ability to seek redress.²³

²³ For example, a longer minimum-day requirement would increase the number of associated persons who left the industry as of the close of the arbitration but not considered inactive. In these instances, customers would not have access to the options because the associated persons would not have been considered inactive while the arbitration is pending. Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 23 cases where an associated person had left

A longer minimum-day requirement, however, also decreases the likelihood that an associated person returns to the industry after being identified as inactive.²⁴ Customers may therefore be less likely to exercise the options under the proposed amendments only for the inactive associated person to return to the industry, and parties may be less likely to incur the associated costs unnecessarily. A shorter minimum-day requirement, on the other hand, may increase the ability of customers to seek redress, but also may increase the costs parties may incur unnecessarily. FINRA believes that the 365-day minimum requirement would provide customers access to the options under the proposed amendments and help ensure that the associated person had permanently left the securities industry.

The 60-day maximum requirement for customers after receiving notice that a firm or an associated person has become inactive to withdraw their claims without prejudice or to amend a pleading would also limit their ability to exercise the options and decrease its associated benefits. The requirement, however, would also limit the effect of an inactive member or associated person on a pending arbitration, and provide certainty that

the industry as of the close of the arbitration but for 60 days or fewer. The number of cases increases to 36 for 120 days, 58 for 180 days, and 129 for 365 days.

²⁴ With a longer minimum-day requirement, fewer associated persons would be deemed inactive as defined under the proposed amendments and then return to the industry. Fewer customers would therefore exercise the options under the proposed amendments only for the associated person to return to the industry. For example, among the 2,054 customer cases in the baseline sample, FINRA is able to identify 59 cases where an associated person was not in the industry while the arbitration was pending but returned to the industry in 60 days or fewer. The number of cases increases to 66 cases for 120 days, 69 cases for 180 days, and 78 cases for 365 days.

the arbitration would continue after the time period had elapsed. FINRA believes that the 60-day maximum requirement would reduce the potential number of disruptions to the arbitration process, while still providing customers access to the proposed options.

5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On October 18, 2017, FINRA published Regulatory Notice 17-33 (“Notice”) to solicit comment on the proposed amendments to the Code that would expand a customer’s options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration as well as allow customers to amend pleadings, postpone hearings and receive a refund of filing fees in these situations.²⁵ FINRA received eight comments on the Notice.²⁶ While all of the commenters supported the proposed rule change discussed in the Notice, some stated that the proposed amendments did not go far enough,²⁷ and six commenters suggested

²⁵ Available at <http://www.finra.org/industry/notices/17-33>.

²⁶ See letters to Marcia E. Asquith including: Steven B. Caruso, Attorney, Maddox Hargett & Caruso, P.C., dated November 20, 2017 (“Caruso”); Gregory M. Curley, Senior Litigation Counsel, Advisor Group, dated December 1, 2017 (“Advisor Group”); William A. Jacobson, Clinical Professor of Law and Tina Davis, Law School Student, Cornell University School of Law, dated December 7, 2017 (“Cornell”); Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated December 15, 2017 (“SIFMA”); Andrew Stoltmann, President, Public Investors Arbitration Bar Association, dated December 18, 2017 (“PIABA”); Justin M. Daley, Legal Intern, St. John’s University School of Law, dated December 18, 2017 (“SJU”); Robin M. Traxler, Vice President, Regulatory Affairs & Associate General Counsel, Financial Services Institute, dated December 18, 2017 (“FSI”); and Joseph Borg, President, North American Securities Administrators Association, Inc., dated December 20, 2017 (“NASAA”).

²⁷ See Caruso, FSI, NASAA, and PIABA.

modifications.²⁸ Commenters who supported the proposed rule change, in general, described it as “a good faith effort to partially address some of the predicates that cause unpaid awards”²⁹ as well as a proposal that would provide customers with additional options and flexibility to alter their litigation strategy.³⁰ Several commenters specifically noted their support for the proposed amendments to FINRA Rule 12100 (Definitions of Inactive Member and Inactive Associated Person),³¹ FINRA Rule 12202 (Claims Against Inactive Members and Inactive Associated Persons),³² FINRA Rule 12309 (Amending

²⁸ See Advisor Group, Cornell, FSI, PIABA, SIFMA, and SJU.

²⁹ See Caruso.

³⁰ See Cornell and NASAA.

³¹ See FSI and SJU. FSI noted that “the proposed amendments address a scenario that is not currently addressed in FINRA rules and, as such, brings important clarity to the arbitration process.” SJU suggested that the proposed changes “offer an important protection to customers...by providing them with “the same options available with respect to individuals who are unregistered associated persons which they now have with respect to firms that are unregistered members.”

³² See Cornell, FSI, PIABA, and SJU. FSI suggested that requiring FINRA to notify customers when a member or an associated person becomes inactive during a pending arbitration would ensure that customers are promptly informed of the change in the firm’s or the associated person’s status. PIABA supported this change as it “would allow a customer to withdraw filed claims without prejudice (or in the case of inactive associated persons, never submit the claim to FINRA Arbitration in the first place), and file a claim in court, regardless of whether the customer signed a predispute arbitration agreement.” SJU supported “requiring the written consent of a customer in proceeding with an arbitration claim with a member or an associated person who is no longer registered,...because it is essential that customers be given a fair opportunity to reconsider their arbitration strategies.”

Pleadings),³³ FINRA Rule 12601 (Postponement of Hearings),³⁴ FINRA Rule 12801 (Default Proceedings)³⁵ and FINRA Rule 12900 (Fees Due When a Claim Is Filed).³⁶

Effectiveness of the Proposed Amendments

Four commenters stated that the proposed rule change is not as effective as it could be.³⁷ FSI suggested that instead of directly addressing the issue of unpaid awards, the proposed rule change amends the arbitration process in ways that would bias the process in favor of one party's subsequent recovery efforts. FINRA's primary role in the arbitration process is to administer cases brought to the forum in a neutral, efficient and fair manner. In its capacity as a neutral administrator of the forum, FINRA must also ensure that its rules are not used to hinder a party's recovery efforts. Moreover, once customers are notified of a member's or associated person's status change during the arbitration case, they should be permitted to assess the collectability of their claims and change strategy during the case without penalty. FINRA believes that, rather than creating bias in the process against a particular group, the proposed rule change instead would provide customers with options under the rules to pursue claims against inactive respondents.

³³ See Caruso, Cornell and PIABA.

³⁴ See Caruso, Cornell, and SJU. SJU stated that "any additional costs involving arbitration could persuade customers to drop otherwise justifiable claims," thus, "the rules should not put undue financial burdens on customers."

³⁵ See Cornell, PIABA, and SJU.

³⁶ See Caruso and Cornell.

³⁷ See supra note 29.

NASAA stated that when awards go unpaid, members and associated persons are not held responsible for their misconduct and investors are left without recourse. Under the Code, a respondent must pay a monetary award within 30 days of receipt.³⁸ In order to incentivize member firms or associated persons to pay customer awards, and restrict those who do not, FINRA expels or suspends from the brokerage industry any member firm or associated person who fails to pay an arbitration award. If a member firm or associated person fails to comply with an arbitration award or a settlement agreement related to an arbitration, FINRA notifies such firm or associated person in writing that the failure to comply within 21 days of service of the notice will result in a suspension or cancellation of membership or a suspension from associating with any member.³⁹ If the threat of suspension is not effective in compelling payment of an award or settlement, FINRA notes that an investor-claimant may take an award to court and have it converted

³⁸ See FINRA Rule 12904(j). An associated person or firm has four available defenses to FINRA disciplinary measures for non-payment in customer cases: (1) the firm or associated person paid the award in full; (2) the parties have agreed to installment payments or have otherwise settled the matter; (3) the firm or associated person has filed a timely motion to vacate or modify the award and such motion has not been denied; and (4) the firm or associated person has filed a petition in bankruptcy and the bankruptcy proceeding is pending or the award has been discharged by the bankruptcy court. See Notice to Members 00-55 (August 2000). In July 2010, FINRA eliminated the “bona fide inability to pay” defense in the expedited suspension proceedings it initiates when a firm or associated person fails to pay an arbitration award to a customer. See Regulatory Notice 10-31 (June 2010).

³⁹ See FINRA Rule 9554(a).

to a judgment. The claimant may then attempt to collect on the judgment using the court's collection procedures.⁴⁰

The remaining two commenters in this group advocated for FINRA to create a monetary solution to address unpaid awards. PIABA stated that FINRA should establish a national investor recovery pool. Caruso suggested a “viable economic solution,” stating “very few investors would be able to actually recover their losses” under the proposed amendments.⁴¹ Although these comments are outside the scope of the proposed rule change, FINRA notes that in its Discussion Paper on Customer Recovery,⁴² FINRA has identified a number of alternative approaches that could be taken to further address the issue of unpaid customer arbitration awards, and FINRA continues to focus on this important issue.⁴³

As noted above, six commenters suggested modifications to the proposed amendments.⁴⁴ FINRA addresses these suggestions in the following discussion.

⁴⁰ An investor-claimant in the FINRA arbitration forum would be in a similar position as a claimant who had brought an action in court and had been awarded the same amount of damages.

⁴¹ Caruso also suggested that FINRA convene a group to consider the extent of the unpaid awards problem and develop solutions to address it.

⁴² See Discussion Paper, FINRA Perspectives on Customer Recovery (February 8, 2018), http://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf.

⁴³ See Discussion Paper at 16-18.

⁴⁴ See supra note 25.

Amendment to Add a Party

Three commenters stated that FINRA should revise the proposed amendment to FINRA Rule 12309(c) to require that a customer's right to add parties to an arbitration case should be subject to the arbitration panel's approval.⁴⁵ Advisor Group suggested that the proposed amendment would prejudice the rights of member firms to participate in the arbitrator selection process⁴⁶ by requiring them to enter the arbitration case after the parties had selected an arbitrator or a panel. FSI suggested that allowing a claimant to add a new party without prior arbitrator or panel approval could cause a party to incur costs in defending against potentially meritless claims. SIFMA stated that allowing a customer claimant to amend his or her pleading after learning that a respondent firm or associated person has become inactive could prejudice the other active respondents remaining in the case by eliminating their right to review the proposed amended pleading, respond in writing, and if there is a claim of prejudice, obtain a ruling on the amended pleading from the panel.

Currently, FINRA Rule 12309 permits a party to amend a pleading any time before the panel is appointed.⁴⁷ Once a panel is appointed, however, the party must

⁴⁵ See Advisor Group, FSI, and SIFMA.

⁴⁶ Arbitrator selection is the process in which the parties receive lists of potential arbitrators and select the panel to hear their case. The number of arbitrators who hear a case is determined by the amount of the claim. See generally Part IV (Appointment, Disqualification, and Authority of Arbitrators) of the Code. See also Arbitrator Selection, <http://www.finra.org/arbitration-and-mediation/arbitrator-selection>.

⁴⁷ See FINRA Rule 12309(a).

receive the panel's approval prior to amending a pleading.⁴⁸ The rule also requires that, if a panel has been selected, a party must request approval from the panel prior to adding a new party.⁴⁹ Under the proposed amendments, if FINRA notifies a customer that a member or associated person has become inactive, proposed FINRA Rules 12309(b) and (c) would make it easier to amend pleadings to add a claim or party by eliminating the need for pre-approval by an arbitrator or panel. If the amended pleading to add a party occurs after panel appointment, the newly-added party would not be able to participate in the arbitration selection process.

In this scenario, FINRA would provide the arbitrator disclosure reports⁵⁰ of the sitting panelists to the parties and permit the parties to raise any conflicts they find with the panel.⁵¹ If a party discovers a conflict, the party may file a motion to recuse the

⁴⁸ See FINRA Rule 12309(b).

⁴⁹ See FINRA Rule 12309(c).

⁵⁰ An arbitrator disclosure report is a summary of the arbitrator's background and is provided to the parties to help them make informed decisions during the arbitrator selection process.

⁵¹ Arbitrators must make a reasonable effort to learn of, and must disclose to the Director, any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, including, for example, any existing or past financial, business, professional, family, social, or other relationships or circumstances with any party, any party's representative, or anyone who the arbitrator is told may be a witness in the proceeding, that are likely to affect impartiality or might reasonably create an appearance of partiality or bias. See FINRA Rule 12405(a). The duty to disclose any relationship, experience and background information that may affect, or even appear to affect, the arbitrator's ability to be impartial and the parties' belief that the arbitrator will be able to render a fair decision, is an ongoing duty. See FINRA Rule 12405(b). Thus, if a party is added under proposed FINRA Rule 12309(c)(2), the panelists must update their disclosures or review them to ensure that further updates are not warranted.

arbitrator.⁵² The arbitrator who is the subject of the motion to recuse would consider whether to withdraw⁵³ from the case and rule on the motion.⁵⁴ The party may also request removal of the arbitrator by the Director, under certain circumstances.⁵⁵

FINRA does not believe that the proposed amendments would encourage claimants to add members or associated persons who have no nexus to the arbitration case as some commenters fear. While the proposed amendments to FINRA Rule 12309 would remove the requirement for arbitrator or panel approval prior to adding a claim or party, FINRA Rule 12309(d) permits any party, whether existing or newly-added, to respond to an amended pleading after it is filed by filing an answer and raising any

⁵² See FINRA Rule 12406.

⁵³ The Code of Ethics for Arbitrators in Commercial Disputes (“Canon of Ethics”) applies to arbitrators on FINRA’s arbitrator rosters. See Canon of Ethics, <http://www.finra.org/arbitration-and-mediation/code-ethics-arbitrators-commercial-disputes>. Canon II provides that if an arbitrator is requested to withdraw by less than all of the parties because of alleged partiality, the arbitrator should withdraw except in two circumstances. In one such circumstance, the arbitrator could consider the matter, determine that the reason for the challenge is not substantial, and that he or she can nevertheless act and decide the case impartially and fairly. See Canon II (An Arbitrator Should Disclose Any Interest Or Relationship Likely To Affect Impartiality Or Which Might Create An Appearance Of Partiality), Section G.

⁵⁴ See FINRA Rule 12406.

⁵⁵ The rule states, in relevant part, that before the first hearing session begins, the Director will grant a party's request to remove an arbitrator if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration. The interest or bias must be definite and capable of reasonable demonstration, rather than remote or speculative. See FINRA Rule 12407(a)(1). After the first hearing session begins, the Director may remove an arbitrator based only on information required to be disclosed under Rule 12405 that was not previously known by the parties. See FINRA Rule 12407(b).

available defenses.⁵⁶ Thus, if the claim or party to be added has no connection to the arbitration case, the respondents would have an opportunity to make that argument to the arbitrator or panel.⁵⁷ It would not be in the claimant's interest, therefore, to add frivolous claims or unnecessary parties, as doing so would likely increase a claimant's costs in supporting the amended pleading and would delay the outcome of the case.

FSI suggested that if the arbitrator or panel no longer has the right to approve adding a new claim or new parties, the proposed amendments could result in orphaned accounts. FSI commented that FSI's members may no longer accept customer accounts from inactive firms to minimize service interruptions because the proposed amendments would "make it easier for, and likely encourage, customers to pursue claims against the firm that accepts the customer accounts."

FINRA believes it is unlikely that a customer would add the firm that accepted his or her accounts from an inactive firm as a party to an arbitration case against the inactive firm because the rules permit the customer to add new parties without pre-approval of the arbitrator or panel. If the customer's new firm has no connection to the dispute involving the inactive firm, yet the customer adds the new firm to the case, the customer risks jeopardizing the business relationship with the new firm, increasing his or her costs to support a frivolous claim, and alienating the panel by adding a member that was not

⁵⁶ See FINRA Rule 12303(a).

⁵⁷ After the newly-added party files an answer, the party could seek to have the claim dismissed prior to the conclusion of the case in chief, on the basis that the moving party was not associated with the account(s), security(ies), or conduct at issue. See FINRA Rules 12504(a)(2) and (a)(6).

associated with the account or conduct at issue⁵⁸ until after the named respondent had gone out of business. FINRA believes, therefore, that these risks outweigh any benefit to the customer who might consider adding a party that has no connection to the arbitration case.

Length of Termination Period for Associated Persons

In the Notice, FINRA proposed to define an "inactive associated person" as a person associated with a member whose registration is revoked or suspended, or whose registration has been terminated for a minimum of 365 days. Three commenters stated that the timeframe should be shortened to 6 months,⁵⁹ 120 days,⁶⁰ or 60 days.⁶¹

FINRA recognizes the commenters' concerns, but believes that the 365-day minimum termination requirement for associated persons would help ensure that enough time has elapsed to assume reasonably that the associated person has permanently left the securities industry. FINRA believes the requirement would benefit those customers who would exercise the option to withdraw the case from the arbitration forum and move it to an alternate venue, because they would have more certainty that the associated person

⁵⁸ After the member responds to the amended claim, the member could then file a motion to dismiss prior to the conclusion of the customer's case on the ground that the member was not associated with the account(s), security(ies), or conduct at issue. See FINRA Rule 12504(a)(6)(B).

⁵⁹ See SJU.

⁶⁰ See Cornell, stating that "FINRA should consider the average time it takes to find new employment, and the economic costs to parties having to pursue a claim when the associated person has left the industry permanently but has not yet hit the 365-day minimum requirement."

⁶¹ See PIABA, stating that "a shorter window simply provides the customer with more options regarding amendment and/or withdrawal of the claims without prejudice."

would not return to the securities industry to exercise his or her rights under the predispute arbitration agreement. Further, the 365-day requirement could reduce potential costs to these customers, as they would save money on filing fees and avoid procedural delays, such as staying the case in an alternate venue and re-starting it in FINRA's arbitration forum, which could result if the associated person is only temporarily out of the industry.

Length of Time to Decide Whether to Withdraw Claim

Under the proposed amendments to FINRA Rule 12202(b), if a member or an associated person becomes inactive during a pending arbitration, FINRA would notify the customer about the status change. The customer would be permitted to withdraw the claim against the inactive member or inactive associated person with or without prejudice within 60 days of receiving notice of a status change.⁶² SJU suggested that the 60-day period should be increased to 90 days to provide the customer with additional time to decide whether to pursue the claim in court (and consult with and secure appropriate counsel), to continue with the arbitration, and to amend pleadings. FINRA believes that once a customer is notified of a member's or associated person's inactive status, the proposed 60-day timeframe is a reasonable amount of time for the customer to decide whether to withdraw the claim, amend the claim or add a party. FINRA believes the 60-day timeframe provides customers with enough time to make informed decisions on how to proceed in the case, while still keeping the case on track for timely resolution,

⁶² Within the same 60-day period, the customer would also be permitted to amend a pleading or add a party without pre-approval from the arbitrator or panel, under the proposed amendments to FINRA Rules 12309(b)(2) and (c)(2).

which could improve the customer's chances at recovery, if an arbitrator or panel issued an award.

Extend the Proposed Amendments to Intra-Industry Cases

The proposed amendments would apply to customer cases only. SIFMA contended that the proposed amendments should apply also to intra-industry cases (i.e., disputes between or among members and associated persons).⁶³ SIFMA stated that “all of the arguments and justifications that FINRA makes in favor of expanding the options available to a customer claimant when dealing with those member firms or associated persons who are responsible for most unpaid awards apply equally to industry claimants when dealing with those same member firms and associated persons.”

FINRA acknowledges SIFMA's concerns. At this time, however, FINRA has decided to apply the proposed amendments to customer cases only because providing customers with more control over the arbitration process when faced with a respondent that likely will not be able to pay an award furthers FINRA's goal of investor protection.

Related Claims Should Be Litigated in Same Forum

Under the proposed amendments to FINRA Rule 12202, claims against inactive firms or inactive associated persons would not be eligible for arbitration, unless the customer agrees in writing to arbitrate after the claim arises. FSI expressed concern that, under the proposed rule change, customers could proceed against a member in arbitration and an associated person in court. In this scenario, FSI stated that the discovery in the customer's case against the associated person in court could reveal additional facts that

⁶³ See FINRA Rule 13000 Series.

the customer could use against the firm in its arbitration case. FSI suggested that the member would not have the opportunity to seek comparable information from the customer during the arbitration case. FSI requested, therefore, that FINRA clarify in the proposed amendments that customers be required to pursue related claims (i.e., a claim against the firm and a claim against the associated person that arise from the same facts and alleged misconduct) in the same forum.

FINRA notes that the goal of the proposed amendments is to provide customers with the same options against an associated person who is inactive at the time of filing as those that currently exist against an inactive member. By providing a customer with the option to pursue his or her claim in court against an inactive associated person, the proposed amendments could result in customers filing claims based on the same facts and circumstances in FINRA arbitration and in court at the same time. FINRA notes that this approach would increase the parties' costs, but would have little effect on a member's access to information during its case with the customer.

FINRA provides the Discovery Guide for customer cases only, which outlines documents that the parties should exchange without arbitrator intervention. The Discovery Guide contains two document production lists of presumptively discoverable documents: one for the firm/associated persons to produce and one for the customer to produce.⁶⁴ Thus, at the outset of the arbitration, the member would be permitted to seek information from the customer that is in the customer's possession or control and is relevant to the member's case. In addition, under the Customer Code, the member would

⁶⁴ See Discovery Guide, <http://www.finra.org/arbitration-and-mediation/discovery-guide>.

be permitted to request additional documents or information from any party in arbitration,⁶⁵ and arbitrators have the authority to issue subpoenas⁶⁶ or orders⁶⁷ compelling discovery if the subject of the request fails to comply with a request. If the customer learns of information during the court proceeding that he or she intends to use during the arbitration proceeding, the customer must provide copies of all documents and materials in the customer's possession or control that have not already been produced at the 20-day exchange deadline.⁶⁸ For these reasons, FINRA declines to amend the proposed rule change as suggested.

Request for Additional FINRA Data

PIABA requested that FINRA release the data and other statistical information FINRA used to support the proposed amendments. FINRA has made available data on which it relied in its discussion of the economic impacts of the proposed amendments.

Minimize Delays and Postponements from Newly-Added Party

PIABA expressed concern that newly-named respondents may demand extended delays and postponements of scheduled hearing dates. PIABA urged FINRA to consider adopting arbitrator training and guidelines to instruct arbitrators to balance carefully the interests of all the parties to the arbitration when considering newly-added respondent requests to extend deadlines or hearings.

⁶⁵ See FINRA Rule 12507.

⁶⁶ See FINRA Rule 12512.

⁶⁷ See FINRA Rule 12513.

⁶⁸ See FINRA Rule 12514.

When FINRA receives approval of proposed rule changes that involve arbitration practices and procedures, FINRA’s Office of Dispute Resolution (“ODR”) will include articles on the new rules in The Neutral Corner, an ODR newsletter for arbitrators and other neutrals that includes updates on rules affecting dispute resolution and tips on how to be a better arbitrator or mediator.⁶⁹ In addition, ODR will develop arbitrator training to explain how the new rules would work and provide guidance to arbitrators on their roles and responsibilities under the new rules. These informational and training materials will provide examples of best practices that arbitrators could use as guides to assist them when they are deciding a newly-added respondent’s request for an extension or postponement. As is current practice under the Code, arbitrators would have the authority under the proposed amendments to exercise their judgment when addressing these matters, based on the facts and circumstances of the case.

Reporting Mechanisms Should Be Accurate and Made Available to the Public

Under the proposed amendments, an “inactive member” would be defined as a member whose membership has been terminated, suspended, cancelled, revoked, the member has been expelled from FINRA, or the member is otherwise defunct. An “inactive associated person” would be defined as a person whose registration is revoked or suspended, who has been expelled or barred from FINRA, or has been terminated for a minimum of 365 days. NASAA suggested that the withdrawal statistic that ODR publishes⁷⁰ should be broken

⁶⁹ The Neutral Corner, Volume 1 – 2019, <http://www.finra.org/arbitration-and-mediation/neutral-corner-volume-1-2019-0319>. See also the previous editions at <http://www.finra.org/arbitration-and-mediation/previous-editions-neutral-corner>.

⁷⁰ Dispute Resolution Statistics, <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics>.

down to reflect the appropriate subcategory (e.g., terminated, suspended, canceled, etc.) that customers use to withdraw their claims. FINRA cannot commit to publishing subcategories of withdrawals as requested, because the programming costs required to capture that level of detail would likely be significant. FINRA agrees, however, that its withdrawal statistics should distinguish between a claim (or case) withdrawn because a claimant exercised rights under the rules after a respondent became inactive and claims withdrawn for other reasons. If the SEC approves the proposed rule change, FINRA would assess its technology platforms to determine what programming changes would be needed to capture the data relating to claims or cases withdrawn due to an inactive respondent.

NASAA also suggested that FINRA create and make public a separate report to capture the members and associated persons who become inactive due to unpaid arbitration awards or judgments in favor of customers. NASAA stated that such a report would provide transparency on industry participants that leave the industry due to customer complaints and would provide customers with additional information when making a decision about whether to work with a specific FINRA member or associated person.

FINRA is committed to providing customers with information on the state of unpaid customer arbitration awards in the forum, so that they may make informed decisions about whom to entrust with their money and, therefore, has made data on

unpaid customer arbitration awards available on its website.⁷¹ Moreover, FINRA has published a list of member firms and associated persons with unpaid customer arbitration awards.⁷² This information will continue to appear on the firm's or individual's BrokerCheck[®]⁷³ report.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.⁷⁴

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

⁷¹ See Statistics on Unpaid Customer Awards in FINRA Arbitration, <http://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration>. FINRA updates these data periodically.

⁷² See Member Firms and Associated Persons with Unpaid Customer Arbitration Awards, <http://www.finra.org/arbitration-and-mediation/members-firms-and-associated-persons-unpaid-customer-arbitration-awards>. FINRA updates these data periodically.

⁷³ FINRA developed and operates this free tool under the oversight of the SEC to provide investors with information regarding a broker's employment history, regulatory actions, investment-related licensing information, arbitrations and complaints. See BrokerCheck[®], <https://brokercheck.finra.org>.

⁷⁴ 15 U.S.C. 78s(b)(2).

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2019-027)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 12000 Series to Expand Options Available to Customers if a Firm or Associated Person is or Becomes Inactive

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 5, 2019, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code” or “Code”) to expand a customer’s options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration. In addition, the proposed amendments would allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees in these situations.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

Most unpaid customer arbitration awards are rendered against firms or individuals whose FINRA registration has been terminated, suspended, cancelled, or revoked, or who have been expelled from FINRA. These firms and individuals are generally referred to as "inactive," and are no longer FINRA members or associated with a FINRA member, although they may continue to operate in another area of the financial services industry where FINRA registration is not required. Firms and individuals can become inactive prior to an arbitration claim being filed, during an arbitration proceeding, or subsequent to an arbitration award, and this status can be caused by FINRA's action, such as when a firm or individual is suspended for failing to pay an award, or by the firm's or individual's own voluntary action.

FINRA has implemented a number of changes to its arbitration program that expand the options available to a customer when dealing with those members or associated persons that are inactive either at the time the claim is filed or at the time of the award. For example, when a customer claimant first files an arbitration claim, FINRA alerts, by letter, the customer claimant if the respondent, whether a member or an associated person, is inactive. FINRA also informs the claimant that awards against such members or associated persons have a much higher incidence of non-payment and that FINRA has limited disciplinary leverage over inactive members or associated persons that fail to pay arbitration awards. Thus, the customer knows before pursuing the claim in arbitration that collection of an award may be more difficult. In addition, upon learning that the member or associated person is inactive, a customer may determine to amend his or her claim to add other respondents from whom the customer may be able to collect should the claim go to award.

Proposed Rule Change

FINRA is proposing to amend the Customer Code³ to expand further the options available to customers in situations where a firm becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. FINRA is also proposing to amend the Code to allow

³ While unpaid awards occur in intra-industry cases (i.e., disputes between or among members and associated persons), the proposed amendments would apply to customer cases only.

customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees if the customer withdraws the claim under these situations.⁴

A. Arbitrating Claims Against Inactive Members and Associated Persons

Currently, under FINRA Rule 12202 (Claims Against Inactive Members), a customer's claim against a firm whose membership is terminated, suspended, cancelled or revoked, or that has been expelled from FINRA, or that is otherwise defunct, is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises. In these situations, the customer is able to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.⁵ Accordingly, claims against inactive firms proceed in arbitration only at the customer's option.

The Code does not address situations, however, where a member firm becomes inactive during a pending arbitration. In addition, the Code does not provide specific procedures for a customer to withdraw, and file in court, a claim against an associated person who becomes inactive before the customer files a claim or during a pending arbitration.

Accordingly, FINRA is proposing to amend FINRA Rule 12202 to expand a customer's option to withdraw a claim to situations where a member becomes inactive

⁴ FINRA is also proposing to amend the Code to update cross-references and make other non-substantive, technical changes to rules impacted by the proposed rule change.

⁵ If the customer notifies FINRA in writing that he or she does not want to proceed against the inactive member in FINRA's forum, FINRA deems the customer's agreement to submit to arbitration rescinded and sends the customer a full refund of any filing fee remitted.

during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. Under the proposal, FINRA Rule 12202 would specify that a customer's claim against an associated person who is inactive at the time the claim is filed is ineligible for arbitration unless the customer agrees in writing to arbitrate after the claim arises. In addition, FINRA Rule 12202 would specify that if a member or an associated person becomes inactive during a pending arbitration, FINRA would notify the customer of the status change, and provide the customer with 60 days to withdraw the claim(s) with or without prejudice.⁶

Similar to the current rules and procedures relating to claims filed against inactive members, the proposed amendments would allow the customer to evaluate the likelihood of collecting on an award and make an informed decision whether to proceed in arbitration, to file the claim in court or to take no action, regardless of whether the customer signed a predispute arbitration agreement.

In addition, FINRA is proposing to amend FINRA Rule 12100 (Definitions) to add definitions of "inactive member" and "inactive associated person." Consistent with current Rule 12202, FINRA is proposing to define an "inactive member" as a member

⁶ FINRA Rule 12702 (Withdrawal of Claims) provides that before a party answers a statement of claim, the claimant can withdraw the claim with or without prejudice. However, after a party submits an answer, the claimant can only withdraw the claim with prejudice unless the panel or the parties agree otherwise. FINRA is proposing to make a conforming change to FINRA Rule 12702 to provide that a customer can withdraw a claim without prejudice if the party that submitted an answer is an inactive member or inactive associated person. Withdrawal without prejudice would allow the customer to re-file the arbitration at a later date.

whose membership is terminated, suspended, cancelled or revoked; that has been expelled or barred⁷ from FINRA, or that is otherwise defunct.⁸

An “inactive associated person” would be defined as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA,⁹ or whose registration has been terminated for a minimum of 365 days. Thus, if an associated person’s registration is not revoked, cancelled, or suspended, the person has not been expelled or barred from FINRA, and the individual’s registration has been terminated for less than one year, the individual would not be classified as terminated and, therefore, would not be deemed inactive.

FINRA believes the 365-day minimum termination¹⁰ requirement for associated persons would help ensure that enough time has elapsed to assume reasonably that the associated person has permanently left the securities industry. The requirement would

⁷ FINRA is adding “or barred” to the definition of an “inactive member” to capture that a member may be inactive due to a bar.

⁸ The proposed rule change would amend the definition of “member” under the Customer Code, the Code of Arbitration Procedure for Industry Disputes (“Industry Code”), and in Article I of the By-Laws of FINRA Regulation, Inc. to conform the definition to the proposed definition of an “inactive member” as discussed below. The proposed changes would make the definition of “member” consistent in the FINRA rules that apply to FINRA’s arbitration forum.

⁹ In Regulatory Notice 17-33 (October 2017), discussed infra, FINRA proposed to define an “inactive associated person” as a person associated with a member whose registration is revoked or suspended, or whose registration has been terminated for a minimum of 365 days. FINRA is proposing to add “expelled or barred from FINRA” and “whose registration is cancelled” to this definition to capture other ways in which an individual could be categorized as inactive.

¹⁰ Termination, in some cases, may be a voluntary action that can be of short duration.

allow enough time for those associated persons who may have temporarily left the industry to return before the arbitration closes.¹¹

B. Amending Pleadings

FINRA Rule 12309 (Amending Pleadings) limits a party's ability to amend a statement of claim, among other pleadings, after FINRA has appointed a panel to the case. Specifically, once FINRA appoints a panel to a case, a party can amend a pleading only if the arbitrators grant a party's motion to do so. FINRA Rule 12309 also provides that a party cannot add a new party to the case after arbitrator ranking lists are due to the Director of Arbitration until FINRA appoints the panel and the arbitrators grant a party's motion to add the new party.

FINRA believes that a customer should be able to change his or her litigation strategy during a pending case once the customer learns that a firm or an associated person has become inactive. Accordingly, FINRA is proposing to amend FINRA Rule 12309 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive during a pending arbitration, the customer may amend a pleading, including adding a new party, within 60 days of receiving such notice.¹²

C. Postponing Hearings

¹¹ In its analysis of 2,054 customer cases closed by hearing, on the papers, or by stipulated award from 2014 to 2018, FINRA identified 78 cases where an associated person was not in the industry while the arbitration was pending but returned to the industry in fewer than 365 days.

¹² FINRA Rule 12309(d) would permit any party to file a response to an amended pleading, provided the response is filed and served within 20 days of receipt of the amended pleading, unless the panel determines otherwise. Thus, the newly-added party could file a response to the amended pleading for the panel or arbitrator to consider.

FINRA Rule 12601 (Postponement of Hearings) addresses when a scheduled hearing date can be postponed. The parties can agree to postpone a hearing. Absent an agreed upon postponement, a hearing can be postponed by FINRA in extraordinary circumstances, by the arbitrators at their discretion, or by the arbitrators upon a party's motion. FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, the customer may postpone the hearing date. Since the proposed amendment would provide a customer with 60 days to determine how to proceed after FINRA notifies the customer of the status change to inactive, it would be appropriate to allow the customer to postpone a scheduled hearing that falls within that time period.

In addition, FINRA assesses postponement fees against the parties for each postponement agreed to by the parties, or granted upon the request of one or more parties. FINRA also charges an additional fee of \$600 per arbitrator if a postponement takes place within 10 days of a scheduled hearing date. The additional \$600 per arbitrator fee is paid to the arbitrators to compensate them for the late adjournment.¹³ FINRA is proposing to amend FINRA Rule 12601 to provide that if FINRA notifies a customer that a firm or an associated person has become inactive and the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, FINRA would not charge the customer a postponement fee or an additional fee of \$600 per arbitrator if a customer chooses to postpone a scheduled hearing.

¹³ See FINRA Rule 12214 (Payment of Arbitrators).

FINRA is also proposing to amend FINRA Rule 12214 to make it clear that it would continue to pay the \$600 honoraria to the arbitrators to compensate them for their time if a customer chooses to postpone a scheduled hearing within 10 days before it is scheduled because the customer learns that the firm or associated person has become inactive.

D. Default Proceedings

FINRA Rule 12801 (Default Proceedings) permits a claimant to request default proceedings against any respondent whose registration is terminated, revoked or suspended, and who failed to file an answer¹⁴ to a claim within the time provided in the Code. A single arbitrator will decide the case based on the claimant's pleadings and other documentation.¹⁵ The claimants must present a sufficient basis to support the making of an award.¹⁶ The arbitrator may not issue an award based solely on the nonappearance of a party.¹⁷

As noted, the proposed amendments would define an inactive associated person as a person associated with a member whose registration is revoked, cancelled, or suspended, who has been expelled or barred from FINRA, or whose registration has been

¹⁴ A respondent must serve each party with a signed and dated Submission Agreement and answer specifying the relevant facts and available defenses to the statement of claim within 45 days of receipt of the statement of claim. See FINRA Rule 12303(a).

¹⁵ See FINRA Rule 12801(b)(2)(B). No hearings are held in default proceedings unless the customer requests one. See FINRA Rule 12801(c).

¹⁶ See FINRA Rule 12801(e)(1).

¹⁷ Id. If the defaulting respondent files an answer before an award has been issued, the proceedings against this respondent will be terminated and the claim will proceed under the regular provisions of the Code. See FINRA Rule 12801(f).

terminated for a minimum of 365 days. In the context of a default proceeding, FINRA believes that it would be appropriate to continue to allow a customer to request default proceedings against any terminated associated person who fails to answer a claim, regardless of how long the associated person has been terminated, consistent with the existing rule. Accordingly, FINRA is proposing to amend FINRA Rule 12801(a) to specify that a claimant may request a default proceeding against a terminated associated person who fails to file an answer within the time provided in the Code regardless of the number of days since termination.¹⁸

E. Refunding Filing Fees

FINRA Rule 12900 (Fees Due When a Claim is Filed) specifies that if a claim is settled or withdrawn more than 10 days before the date that the hearing is scheduled to begin, a party paying a filing fee will receive a partial refund of the filing fee. The rule also provides that FINRA will not refund any portion of the filing fee if a claim is settled or withdrawn within 10 days of the date that the hearing is scheduled to begin.

FINRA is proposing to amend FINRA Rule 12900 to provide that FINRA would refund a customer's full filing fee if FINRA notifies a customer that a firm or an associated person has become inactive during a pending arbitration, and the customer withdraws the case against all parties within 60 days of the notification. FINRA would refund the filing fee even if the customer withdraws the case within 10 days of the date that the hearing is scheduled to begin.

¹⁸ See supra note 10.

F. Non-substantive changes

In addition to amending FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 to expand a customer's options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration, FINRA is also proposing to amend the Code to update cross-references and make other non-substantive, technical changes to the rules impacted by the proposal.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed rule change would protect investors and the public interest by expanding the options available to customers with claims against respondents who are unlikely to be able to pay. The proposed rule change would extend the concept of what it means to be inactive to expressly include associated persons, so that customers would have the same options during a case against inactive associated

¹⁹ 15 U.S.C. 78q-3(b)(6).

persons as they would against inactive members. The proposed change, therefore, would add consistency to FINRA rules.

Further, FINRA believes that the proposed amendments would provide customers with expanded options and flexibility to change case strategy if FINRA notifies them that a member or associated person has become inactive during a pending arbitration. In particular, the proposed rule change would permit a customer to amend his or her pleading or to add parties without arbitrator intervention. FINRA rules, however, permit the newly-added party to respond to the amended pleading and to have the panel or arbitrator consider any objections.

The proposed rule change would also clarify the default rule to include an inactive associated person who does not answer a claim, regardless of the number of days since termination. FINRA believes that the proposed rule change would add consistency to FINRA's default rule so that the procedures would apply to inactive members and inactive associated persons equally. As a result, investors would know that they have the same options and rights in default proceedings against any inactive respondent under the Customer Code. FINRA believes this could help expedite these arbitration cases, as any ambiguity about how the rule should be applied would be removed. Moreover, FINRA believes that exempting the minimum-day termination requirement would prevent an associated person from using the 365-day requirement as a shield to delay the arbitration case.

FINRA believes that the proposed amendments provide customers with more options and flexibility in how they choose to resolve claims against respondents who are unlikely to pay, and, thus, give them more control over the arbitration case when they are

notified that a member or associated person has become inactive. Moreover, by eliminating the postponement fees and refunding filing fees in certain circumstances, the proposed amendments eliminate these costs as a potential barrier for customers who may opt to pursue their claims in other forums. For these reasons, FINRA believes that the proposed rule change protects investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed amendments will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. A discussion of the economic impacts of the proposed amendments follows.

Economic Impact Assessment

(a) Regulatory Need

The Code addresses situations where customers bring claims against inactive members. The Code does not address situations, however, where a member firm becomes inactive during a pending arbitration or where an associated person becomes inactive before a claim is filed or during a pending arbitration. This may limit the options available to customers to seek redress, as well as their ability to collect an award.

(b) Economic Baseline

The economic baseline for the proposed amendments is the current rules under the Code that address customer disputes in arbitration. The proposed amendments are expected to affect the parties to an arbitration, including customers, member firms, associated persons, and arbitrators.

FINRA is able to identify 2,054 customer cases closed by hearing, on the papers, or by stipulated award from 2014 to 2018. Among these cases, FINRA is able to identify

128 cases (six percent) where a member firm would have been defined as inactive (under the proposed amendments) before an arbitration. In these instances, the current rules under the Code provide customers the option to proceed in arbitration, to file the claim in court, or to take no action regardless of whether the customer signed a pre-dispute arbitration agreement. Customers are therefore able to evaluate the likelihood of collecting on an award and to choose the forum in which to proceed.

FINRA is also able to identify 427 cases (21 percent of 2,054) where a firm became inactive during a pending arbitration, or where an associated person would have been identified as inactive (under the proposed amendments) either before or during a pending arbitration. The current rules do not provide similar options to customers in these instances, and customers may be less able to choose the forum in which to proceed or to change their litigation strategy during a pending case.²⁰

(c) Economic Impact

The proposed amendments would expand customers' options under the Code where a member becomes inactive during a pending arbitration or where an associated person becomes inactive before a claim is filed or during a pending arbitration. The benefits and costs of the proposed amendments are discussed below.

²⁰ In the 427 cases, the total amount of compensatory damages sought by customers was \$580.3 million, and customers were awarded compensatory damages of \$96.0 million. For the 347 cases that closed from 2014 through 2017, 126 relate to an award that went unpaid, and the member firms or associated persons responsible for the unpaid awards would have been identified as inactive under the proposed amendments. The total amount of awards relating to these cases that went unpaid was \$55.9 million. The respondents that would have been identified as inactive were responsible for nearly all of the awards that went unpaid.

In general, the benefits of the proposed amendments arise from the expansion of customer options under the Code when a member becomes inactive during a pending arbitration, or when an associated person becomes inactive before a claim is filed or during a pending arbitration. In these instances, the proposed amendments would increase the flexibility of customers to determine whether and how to proceed in arbitration. Customers would exercise the options under the proposed amendments if they believe it would increase their ability to seek redress, and may increase the amount of monetary compensation they expect to receive.

The expansion of customer options under the Code would arise from the reduction of the restrictions and penalties to alter their litigation strategy in arbitration or to withdraw their claims from arbitration. For example, customers who proceed in arbitration may amend a pleading without arbitrators granting the motion. This includes the addition of a new respondent from whom the customer may be able to collect should the claim go to award. Customers who proceed in arbitration may also postpone a scheduled hearing without penalty to assess the options and gain additional time to prepare.²¹ Customers may also withdraw their claim without prejudice if the party that submitted an answer is an inactive member or inactive associated person. Customers who withdraw their claims against all parties within the allotted time would also receive a full refund of the filing fee.

²¹ Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 240 (12 percent) cases where a member or an associated person would have been identified as inactive after arbitrator ranking lists were due or FINRA appointed a panel. FINRA is also able to identify 119 (six percent) cases where a member or an associated person would have been identified as inactive within 60 days of a scheduled hearing.

Customers who exercise the options under the proposed amendments, and the member firms and associated persons who are also parties to the arbitration, may incur additional costs. For example, if customers withdraw their claims from arbitration and restart the case in another venue, then the parties may incur additional legal expense and time to resolve the dispute. If instead customers amend their pleadings but remain in arbitration, the parties (including member firms and associated persons who are newly-named in the amended pleadings) may also incur additional legal expense to alter their litigation strategy, time to resolve the dispute, and forum fees (e.g., hearing session fees).²² Parties may also incur additional time to resolve the dispute if customers postpone scheduled hearings. Customers have the option to incur these additional expenses, and would likely incur them only if they believe the costs would increase the amount of monetary compensation they may expect to receive.

The proposed amendments would provide no significant benefits and impose no material costs on customers who would not change their behavior when notified of an associated person's or firm's change of status during arbitration in the presence of the amendments, nor on the members and associated persons who are party to their claims. In FINRA's experience, customers typically proceed in arbitration when notified that a member is inactive at the time of filing, and typically remain in arbitration when a member or an associated person leaves the industry while the arbitration is pending.²³

²² FINRA does not believe, however, that the proposed amendments would cause member firms and associated persons to be named without having a connection to the case. See discussion in Section II.C.

²³ Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 297 (14 percent) cases where a member firm or an associated person would have been identified as inactive during a pending arbitration.

One reason customers remain in arbitration when a member or an associated person leaves the industry may be the additional costs of restarting a case in another venue. Another reason may be the expectation that another forum would not result in a higher likelihood of redress.

Based on this experience, FINRA believes that few customers would withdraw claims from the forum in the presence of the proposed rules, but would instead remain in arbitration. Customers are, therefore, more likely to exercise their new options under the proposed amendments to amend pleadings or to postpone hearings. The benefits and costs of the proposed amendments, therefore, may result more from the amendment of pleadings or the rescheduling of hearings than the withdrawal of claims.

(d) Alternatives Considered

FINRA exercised discretion in setting the minimum number of days for a terminated associated person to be considered inactive (365). FINRA also exercised discretion when setting the maximum number of days for customers to exercise the options under the proposed amendments after they receive notification of the inactive status of a member or an associated person (60).

The minimum-day requirement for a terminated associated person to be considered inactive affects the length of time that customers must wait before being able to exercise the options under the proposed amendments. A longer minimum-day requirement decreases the number of customers who may have access to the options under the proposed amendments, and therefore decreases their ability to seek redress.²⁴

²⁴ For example, a longer minimum-day requirement would increase the number of associated persons who left the industry as of the close of the arbitration but not considered inactive. In these instances, customers would not have access to the

A longer minimum-day requirement, however, also decreases the likelihood that an associated person returns to the industry after being identified as inactive.²⁵ Customers may therefore be less likely to exercise the options under the proposed amendments only for the inactive associated person to return to the industry, and parties may be less likely to incur the associated costs unnecessarily. A shorter minimum-day requirement, on the other hand, may increase the ability of customers to seek redress, but also may increase the costs parties may incur unnecessarily. FINRA believes that the 365-day minimum requirement would provide customers access to the options under the proposed amendments and help ensure that the associated person had permanently left the securities industry.

The 60-day maximum requirement for customers after receiving notice that a firm or an associated person has become inactive to withdraw their claims without prejudice or to amend a pleading would also limit their ability to exercise the options and decrease its associated benefits. The requirement, however, would also limit the effect of an

options because the associated persons would not have been considered inactive while the arbitration is pending. Among the 2,054 customer cases in the baseline sample, FINRA is able to identify 23 cases where an associated person had left the industry as of the close of the arbitration but for 60 days or fewer. The number of cases increases to 36 for 120 days, 58 for 180 days, and 129 for 365 days.

²⁵ With a longer minimum-day requirement, fewer associated persons would be deemed inactive as defined under the proposed amendments and then return to the industry. Fewer customers would therefore exercise the options under the proposed amendments only for the associated person to return to the industry. For example, among the 2,054 customer cases in the baseline sample, FINRA is able to identify 59 cases where an associated person was not in the industry while the arbitration was pending but returned to the industry in 60 days or fewer. The number of cases increases to 66 cases for 120 days, 69 cases for 180 days, and 78 cases for 365 days.

inactive member or associated person on a pending arbitration, and provide certainty that the arbitration would continue after the time period had elapsed. FINRA believes that the 60-day maximum requirement would reduce the potential number of disruptions to the arbitration process, while still providing customers access to the proposed options.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On October 18, 2017, FINRA published Regulatory Notice 17-33 (“Notice”) to solicit comment on the proposed amendments to the Code that would expand a customer’s options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration as well as allow customers to amend pleadings, postpone hearings and receive a refund of filing fees in these situations.²⁶ FINRA received eight comments on the Notice.²⁷ While all of the commenters supported the proposed rule change discussed in the Notice, some stated that the proposed amendments did not go far enough,²⁸ and six commenters suggested

²⁶ Available at <http://www.finra.org/industry/notices/17-33>.

²⁷ See letters to Marcia E. Asquith including: Steven B. Caruso, Attorney, Maddox Hargett & Caruso, P.C., dated November 20, 2017 (“Caruso”); Gregory M. Curley, Senior Litigation Counsel, Advisor Group, dated December 1, 2017 (“Advisor Group”); William A. Jacobson, Clinical Professor of Law and Tina Davis, Law School Student, Cornell University School of Law, dated December 7, 2017 (“Cornell”); Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated December 15, 2017 (“SIFMA”); Andrew Stoltmann, President, Public Investors Arbitration Bar Association, dated December 18, 2017 (“PIABA”); Justin M. Daley, Legal Intern, St. John’s University School of Law, dated December 18, 2017 (“SJU”); Robin M. Traxler, Vice President, Regulatory Affairs & Associate General Counsel, Financial Services Institute, dated December 18, 2017 (“FSI”); and Joseph Borg, President, North American Securities Administrators Association, Inc., dated December 20, 2017 (“NASAA”).

²⁸ See Caruso, FSI, NASAA, and PIABA.

modifications.²⁹ Commenters who supported the proposed rule change, in general, described it as “a good faith effort to partially address some of the predicates that cause unpaid awards”³⁰ as well as a proposal that would provide customers with additional options and flexibility to alter their litigation strategy.³¹ Several commenters specifically noted their support for the proposed amendments to FINRA Rule 12100 (Definitions of Inactive Member and Inactive Associated Person),³² FINRA Rule 12202 (Claims Against Inactive Members and Inactive Associated Persons),³³ FINRA Rule 12309 (Amending

²⁹ See Advisor Group, Cornell, FSI, PIABA, SIFMA, and SJU.

³⁰ See Caruso.

³¹ See Cornell and NASAA.

³² See FSI and SJU. FSI noted that “the proposed amendments address a scenario that is not currently addressed in FINRA rules and, as such, brings important clarity to the arbitration process.” SJU suggested that the proposed changes “offer an important protection to customers...by providing them with “the same options available with respect to individuals who are unregistered associated persons which they now have with respect to firms that are unregistered members.”

³³ See Cornell, FSI, PIABA, and SJU. FSI suggested that requiring FINRA to notify customers when a member or an associated person becomes inactive during a pending arbitration would ensure that customers are promptly informed of the change in the firm’s or the associated person’s status. PIABA supported this change as it “would allow a customer to withdraw filed claims without prejudice (or in the case of inactive associated persons, never submit the claim to FINRA Arbitration in the first place), and file a claim in court, regardless of whether the customer signed a predispute arbitration agreement.” SJU supported “requiring the written consent of a customer in proceeding with an arbitration claim with a member or an associated person who is no longer registered,...because it is essential that customers be given a fair opportunity to reconsider their arbitration strategies.”

Pleadings),³⁴ FINRA Rule 12601 (Postponement of Hearings),³⁵ FINRA Rule 12801 (Default Proceedings)³⁶ and FINRA Rule 12900 (Fees Due When a Claim Is Filed).³⁷

Effectiveness of the Proposed Amendments

Four commenters stated that the proposed rule change is not as effective as it could be.³⁸ FSI suggested that instead of directly addressing the issue of unpaid awards, the proposed rule change amends the arbitration process in ways that would bias the process in favor of one party's subsequent recovery efforts. FINRA's primary role in the arbitration process is to administer cases brought to the forum in a neutral, efficient and fair manner. In its capacity as a neutral administrator of the forum, FINRA must also ensure that its rules are not used to hinder a party's recovery efforts. Moreover, once customers are notified of a member's or associated person's status change during the arbitration case, they should be permitted to assess the collectability of their claims and change strategy during the case without penalty. FINRA believes that, rather than creating bias in the process against a particular group, the proposed rule change instead would provide customers with options under the rules to pursue claims against inactive respondents.

³⁴ See Caruso, Cornell and PIABA.

³⁵ See Caruso, Cornell, and SJU. SJU stated that "any additional costs involving arbitration could persuade customers to drop otherwise justifiable claims," thus, "the rules should not put undue financial burdens on customers."

³⁶ See Cornell, PIABA, and SJU.

³⁷ See Caruso and Cornell.

³⁸ See supra note 30.

NASAA stated that when awards go unpaid, members and associated persons are not held responsible for their misconduct and investors are left without recourse. Under the Code, a respondent must pay a monetary award within 30 days of receipt.³⁹ In order to incentivize member firms or associated persons to pay customer awards, and restrict those who do not, FINRA expels or suspends from the brokerage industry any member firm or associated person who fails to pay an arbitration award. If a member firm or associated person fails to comply with an arbitration award or a settlement agreement related to an arbitration, FINRA notifies such firm or associated person in writing that the failure to comply within 21 days of service of the notice will result in a suspension or cancellation of membership or a suspension from associating with any member.⁴⁰ If the threat of suspension is not effective in compelling payment of an award or settlement, FINRA notes that an investor-claimant may take an award to court and have it converted to a judgment. The claimant may then attempt to collect on the judgment using the court's collection procedures.⁴¹

³⁹ See FINRA Rule 12904(j). An associated person or firm has four available defenses to FINRA disciplinary measures for non-payment in customer cases: (1) the firm or associated person paid the award in full; (2) the parties have agreed to installment payments or have otherwise settled the matter; (3) the firm or associated person has filed a timely motion to vacate or modify the award and such motion has not been denied; and (4) the firm or associated person has filed a petition in bankruptcy and the bankruptcy proceeding is pending or the award has been discharged by the bankruptcy court. See Notice to Members 00-55 (August 2000). In July 2010, FINRA eliminated the "bona fide inability to pay" defense in the expedited suspension proceedings it initiates when a firm or associated person fails to pay an arbitration award to a customer. See Regulatory Notice 10-31 (June 2010).

⁴⁰ See FINRA Rule 9554(a).

⁴¹ An investor-claimant in the FINRA arbitration forum would be in a similar position as a claimant who had brought an action in court and had been awarded the same amount of damages.

The remaining two commenters in this group advocated for FINRA to create a monetary solution to address unpaid awards. PIABA stated that FINRA should establish a national investor recovery pool. Caruso suggested a “viable economic solution,” stating “very few investors would be able to actually recover their losses” under the proposed amendments.⁴² Although these comments are outside the scope of the proposed rule change, FINRA notes that in its Discussion Paper on Customer Recovery,⁴³ FINRA has identified a number of alternative approaches that could be taken to further address the issue of unpaid customer arbitration awards, and FINRA continues to focus on this important issue.⁴⁴

As noted above, six commenters suggested modifications to the proposed amendments.⁴⁵ FINRA addresses these suggestions in the following discussion.

Amendment to Add a Party

Three commenters stated that FINRA should revise the proposed amendment to FINRA Rule 12309(c) to require that a customer’s right to add parties to an arbitration case should be subject to the arbitration panel’s approval.⁴⁶ Advisor Group suggested that the proposed amendment would prejudice the rights of member firms to participate

⁴² Caruso also suggested that FINRA convene a group to consider the extent of the unpaid awards problem and develop solutions to address it.

⁴³ See Discussion Paper, FINRA Perspectives on Customer Recovery (February 8, 2018), http://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf.

⁴⁴ See Discussion Paper at 16-18.

⁴⁵ See supra note 26.

⁴⁶ See Advisor Group, FSI, and SIFMA.

in the arbitrator selection process⁴⁷ by requiring them to enter the arbitration case after the parties had selected an arbitrator or a panel. FSI suggested that allowing a claimant to add a new party without prior arbitrator or panel approval could cause a party to incur costs in defending against potentially meritless claims. SIFMA stated that allowing a customer claimant to amend his or her pleading after learning that a respondent firm or associated person has become inactive could prejudice the other active respondents remaining in the case by eliminating their right to review the proposed amended pleading, respond in writing, and if there is a claim of prejudice, obtain a ruling on the amended pleading from the panel.

Currently, FINRA Rule 12309 permits a party to amend a pleading any time before the panel is appointed.⁴⁸ Once a panel is appointed, however, the party must receive the panel's approval prior to amending a pleading.⁴⁹ The rule also requires that, if a panel has been selected, a party must request approval from the panel prior to adding a new party.⁵⁰ Under the proposed amendments, if FINRA notifies a customer that a member or associated person has become inactive, proposed FINRA Rules 12309(b) and (c) would make it easier to amend pleadings to add a claim or party by eliminating the need for pre-approval by an arbitrator or panel. If the amended pleading to add a party

⁴⁷ Arbitrator selection is the process in which the parties receive lists of potential arbitrators and select the panel to hear their case. The number of arbitrators who hear a case is determined by the amount of the claim. See generally Part IV (Appointment, Disqualification, and Authority of Arbitrators) of the Code. See also Arbitrator Selection, <http://www.finra.org/arbitration-and-mediation/arbitrator-selection>.

⁴⁸ See FINRA Rule 12309(a).

⁴⁹ See FINRA Rule 12309(b).

⁵⁰ See FINRA Rule 12309(c).

occurs after panel appointment, the newly-added party would not be able to participate in the arbitration selection process.

In this scenario, FINRA would provide the arbitrator disclosure reports⁵¹ of the sitting panelists to the parties and permit the parties to raise any conflicts they find with the panel.⁵² If a party discovers a conflict, the party may file a motion to recuse the arbitrator.⁵³ The arbitrator who is the subject of the motion to recuse would consider whether to withdraw⁵⁴ from the case and rule on the motion.⁵⁵ The party may also request removal of the arbitrator by the Director, under certain circumstances.⁵⁶

⁵¹ An arbitrator disclosure report is a summary of the arbitrator's background and is provided to the parties to help them make informed decisions during the arbitrator selection process.

⁵² Arbitrators must make a reasonable effort to learn of, and must disclose to the Director, any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, including, for example, any existing or past financial, business, professional, family, social, or other relationships or circumstances with any party, any party's representative, or anyone who the arbitrator is told may be a witness in the proceeding, that are likely to affect impartiality or might reasonably create an appearance of partiality or bias. See FINRA Rule 12405(a). The duty to disclose any relationship, experience and background information that may affect, or even appear to affect, the arbitrator's ability to be impartial and the parties' belief that the arbitrator will be able to render a fair decision, is an ongoing duty. See FINRA Rule 12405(b). Thus, if a party is added under proposed FINRA Rule 12309(c)(2), the panelists must update their disclosures or review them to ensure that further updates are not warranted.

⁵³ See FINRA Rule 12406.

⁵⁴ The Code of Ethics for Arbitrators in Commercial Disputes ("Canon of Ethics") applies to arbitrators on FINRA's arbitrator rosters. See Canon of Ethics, <http://www.finra.org/arbitration-and-mediation/code-ethics-arbitrators-commercial-disputes>. Canon II provides that if an arbitrator is requested to withdraw by less than all of the parties because of alleged partiality, the arbitrator should withdraw except in two circumstances. In one such circumstance, the arbitrator could consider the matter, determine that the reason for the challenge is not substantial, and that he or she can nevertheless act and decide the case impartially and fairly. See Canon II (An Arbitrator Should Disclose Any Interest

FINRA does not believe that the proposed amendments would encourage claimants to add members or associated persons who have no nexus to the arbitration case as some commenters fear. While the proposed amendments to FINRA Rule 12309 would remove the requirement for arbitrator or panel approval prior to adding a claim or party, FINRA Rule 12309(d) permits any party, whether existing or newly-added, to respond to an amended pleading after it is filed by filing an answer and raising any available defenses.⁵⁷ Thus, if the claim or party to be added has no connection to the arbitration case, the respondents would have an opportunity to make that argument to the arbitrator or panel.⁵⁸ It would not be in the claimant's interest, therefore, to add frivolous claims or unnecessary parties, as doing so would likely increase a claimant's costs in supporting the amended pleading and would delay the outcome of the case.

Or Relationship Likely To Affect Impartiality Or Which Might Create An Appearance Of Partiality), Section G.

⁵⁵ See FINRA Rule 12406.

⁵⁶ The rule states, in relevant part, that before the first hearing session begins, the Director will grant a party's request to remove an arbitrator if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration. The interest or bias must be definite and capable of reasonable demonstration, rather than remote or speculative. See FINRA Rule 12407(a)(1). After the first hearing session begins, the Director may remove an arbitrator based only on information required to be disclosed under Rule 12405 that was not previously known by the parties. See FINRA Rule 12407(b).

⁵⁷ See FINRA Rule 12303(a).

⁵⁸ After the newly-added party files an answer, the party could seek to have the claim dismissed prior to the conclusion of the case in chief, on the basis that the moving party was not associated with the account(s), security(ies), or conduct at issue. See FINRA Rules 12504(a)(2) and (a)(6).

FSI suggested that if the arbitrator or panel no longer has the right to approve adding a new claim or new parties, the proposed amendments could result in orphaned accounts. FSI commented that FSI's members may no longer accept customer accounts from inactive firms to minimize service interruptions because the proposed amendments would "make it easier for, and likely encourage, customers to pursue claims against the firm that accepts the customer accounts."

FINRA believes it is unlikely that a customer would add the firm that accepted his or her accounts from an inactive firm as a party to an arbitration case against the inactive firm because the rules permit the customer to add new parties without pre-approval of the arbitrator or panel. If the customer's new firm has no connection to the dispute involving the inactive firm, yet the customer adds the new firm to the case, the customer risks jeopardizing the business relationship with the new firm, increasing his or her costs to support a frivolous claim, and alienating the panel by adding a member that was not associated with the account or conduct at issue⁵⁹ until after the named respondent had gone out of business. FINRA believes, therefore, that these risks outweigh any benefit to the customer who might consider adding a party that has no connection to the arbitration case.

Length of Termination Period for Associated Persons

In the Notice, FINRA proposed to define an "inactive associated person" as a person associated with a member whose registration is revoked or suspended, or whose

⁵⁹ After the member responds to the amended claim, the member could then file a motion to dismiss prior to the conclusion of the customer's case on the ground that the member was not associated with the account(s), security(ies), or conduct at issue. See FINRA Rule 12504(a)(6)(B).

registration has been terminated for a minimum of 365 days. Three commenters stated that the timeframe should be shortened to 6 months,⁶⁰ 120 days,⁶¹ or 60 days.⁶²

FINRA recognizes the commenters' concerns, but believes that the 365-day minimum termination requirement for associated persons would help ensure that enough time has elapsed to assume reasonably that the associated person has permanently left the securities industry. FINRA believes the requirement would benefit those customers who would exercise the option to withdraw the case from the arbitration forum and move it to an alternate venue, because they would have more certainty that the associated person would not return to the securities industry to exercise his or her rights under the predispute arbitration agreement. Further, the 365-day requirement could reduce potential costs to these customers, as they would save money on filing fees and avoid procedural delays, such as staying the case in an alternate venue and re-starting it in FINRA's arbitration forum, which could result if the associated person is only temporarily out of the industry.

Length of Time to Decide Whether to Withdraw Claim

Under the proposed amendments to FINRA Rule 12202(b), if a member or an associated person becomes inactive during a pending arbitration, FINRA would notify the customer about the status change. The customer would be permitted to withdraw the

⁶⁰ See SJU.

⁶¹ See Cornell, stating that "FINRA should consider the average time it takes to find new employment, and the economic costs to parties having to pursue a claim when the associated person has left the industry permanently but has not yet hit the 365-day minimum requirement."

⁶² See PIABA, stating that "a shorter window simply provides the customer with more options regarding amendment and/or withdrawal of the claims without prejudice."

claim against the inactive member or inactive associated person with or without prejudice within 60 days of receiving notice of a status change.⁶³ SJU suggested that the 60-day period should be increased to 90 days to provide the customer with additional time to decide whether to pursue the claim in court (and consult with and secure appropriate counsel), to continue with the arbitration, and to amend pleadings. FINRA believes that once a customer is notified of a member's or associated person's inactive status, the proposed 60-day timeframe is a reasonable amount of time for the customer to decide whether to withdraw the claim, amend the claim or add a party. FINRA believes the 60-day timeframe provides customers with enough time to make informed decisions on how to proceed in the case, while still keeping the case on track for timely resolution, which could improve the customer's chances at recovery, if an arbitrator or panel issued an award.

Extend the Proposed Amendments to Intra-Industry Cases

The proposed amendments would apply to customer cases only. SIFMA contended that the proposed amendments should apply also to intra-industry cases (i.e., disputes between or among members and associated persons).⁶⁴ SIFMA stated that "all of the arguments and justifications that FINRA makes in favor of expanding the options available to a customer claimant when dealing with those member firms or associated persons who are responsible for most unpaid awards apply equally to industry claimants when dealing with those same member firms and associated persons."

⁶³ Within the same 60-day period, the customer would also be permitted to amend a pleading or add a party without pre-approval from the arbitrator or panel, under the proposed amendments to FINRA Rules 12309(b)(2) and (c)(2).

⁶⁴ See FINRA Rule 13000 Series.

FINRA acknowledges SIFMA's concerns. At this time, however, FINRA has decided to apply the proposed amendments to customer cases only because providing customers with more control over the arbitration process when faced with a respondent that likely will not be able to pay an award furthers FINRA's goal of investor protection.

Related Claims Should Be Litigated in Same Forum

Under the proposed amendments to FINRA Rule 12202, claims against inactive firms or inactive associated persons would not be eligible for arbitration, unless the customer agrees in writing to arbitrate after the claim arises. FSI expressed concern that, under the proposed rule change, customers could proceed against a member in arbitration and an associated person in court. In this scenario, FSI stated that the discovery in the customer's case against the associated person in court could reveal additional facts that the customer could use against the firm in its arbitration case. FSI suggested that the member would not have the opportunity to seek comparable information from the customer during the arbitration case. FSI requested, therefore, that FINRA clarify in the proposed amendments that customers be required to pursue related claims (i.e., a claim against the firm and a claim against the associated person that arise from the same facts and alleged misconduct) in the same forum.

FINRA notes that the goal of the proposed amendments is to provide customers with the same options against an associated person who is inactive at the time of filing as those that currently exist against an inactive member. By providing a customer with the option to pursue his or her claim in court against an inactive associated person, the proposed amendments could result in customers filing claims based on the same facts and circumstances in FINRA arbitration and in court at the same time. FINRA notes that this

approach would increase the parties' costs, but would have little effect on a member's access to information during its case with the customer.

FINRA provides the Discovery Guide for customer cases only, which outlines documents that the parties should exchange without arbitrator intervention. The Discovery Guide contains two document production lists of presumptively discoverable documents: one for the firm/associated persons to produce and one for the customer to produce.⁶⁵ Thus, at the outset of the arbitration, the member would be permitted to seek information from the customer that is in the customer's possession or control and is relevant to the member's case. In addition, under the Customer Code, the member would be permitted to request additional documents or information from any party in arbitration,⁶⁶ and arbitrators have the authority to issue subpoenas⁶⁷ or orders⁶⁸ compelling discovery if the subject of the request fails to comply with a request. If the customer learns of information during the court proceeding that he or she intends to use during the arbitration proceeding, the customer must provide copies of all documents and materials in customer's possession or control that have not already been produced at the 20-day exchange deadline.⁶⁹ For these reasons, FINRA declines to amend the proposed rule change as suggested.

Request for Additional FINRA Data

⁶⁵ See Discovery Guide, <http://www.finra.org/arbitration-and-mediation/discovery-guide>.

⁶⁶ See FINRA Rule 12507.

⁶⁷ See FINRA Rule 12512.

⁶⁸ See FINRA Rule 12513.

⁶⁹ See FINRA Rule 12514.

PIABA requested that FINRA release the data and other statistical information FINRA used to support the proposed amendments. FINRA has made available data on which it relied in its discussion of the economic impacts of the proposed amendments.

Minimize Delays and Postponements from Newly-Added Party

PIABA expressed concern that newly-named respondents may demand extended delays and postponements of scheduled hearing dates. PIABA urged FINRA to consider adopting arbitrator training and guidelines to instruct arbitrators to balance carefully the interests of all the parties to the arbitration when considering newly-added respondent requests to extend deadlines or hearings.

When FINRA receives approval of proposed rule changes that involve arbitration practices and procedures, FINRA's Office of Dispute Resolution ("ODR") will include articles on the new rules in The Neutral Corner, an ODR newsletter for arbitrators and other neutrals that includes updates on rules affecting dispute resolution and tips on how to be a better arbitrator or mediator.⁷⁰ In addition, ODR will develop arbitrator training to explain how the new rules would work and provide guidance to arbitrators on their roles and responsibilities under the new rules. These informational and training materials will provide examples of best practices that arbitrators could use as guides to assist them when they are deciding a newly-added respondent's request for an extension or postponement. As is current practice under the Code, arbitrators would have the authority under the proposed amendments to exercise their judgment when addressing these matters, based on the facts and circumstances of the case.

⁷⁰ The Neutral Corner, Volume 1 – 2019, <http://www.finra.org/arbitration-and-mediation/neutral-corner-volume-1-2019-0319>. See also the previous editions at <http://www.finra.org/arbitration-and-mediation/previous-editions-neutral-corner>.

Reporting Mechanisms Should Be Accurate and Made Available to the Public

Under the proposed amendments, an “inactive member” would be defined as a member whose membership has been terminated, suspended, cancelled, revoked, the member has been expelled from FINRA, or the member is otherwise defunct. An “inactive associated person” would be defined as a person whose registration is revoked or suspended, who has been expelled or barred from FINRA, or has been terminated for a minimum of 365 days. NASAA suggested that the withdrawal statistic that ODR publishes⁷¹ should be broken down to reflect the appropriate subcategory (e.g., terminated, suspended, canceled, etc.) that customers use to withdraw their claims. FINRA cannot commit to publishing subcategories of withdrawals as requested, because the programming costs required to capture that level of detail would likely be significant. FINRA agrees, however, that its withdrawal statistics should distinguish between a claim (or case) withdrawn because a claimant exercised rights under the rules after a respondent became inactive and claims withdrawn for other reasons. If the SEC approves the proposed rule change, FINRA would assess its technology platforms to determine what programming changes would be needed to capture the data relating to claims or cases withdrawn due to an inactive respondent.

NASAA also suggested that FINRA create and make public a separate report to capture the members and associated persons who become inactive due to unpaid arbitration awards or judgments in favor of customers. NASAA stated that such a report would provide transparency on industry participants that leave the industry due to customer complaints and would provide customers with additional information when

⁷¹ Dispute Resolution Statistics, <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics>.

making a decision about whether to work with a specific FINRA member or associated person.

FINRA is committed to providing customers with information on the state of unpaid customer arbitration awards in the forum, so that they may make informed decisions about whom to entrust with their money and, therefore, has made data on unpaid customer arbitration awards available on its website.⁷² Moreover, FINRA has published a list of member firms and associated persons with unpaid customer arbitration awards.⁷³ This information will continue to appear on the firm's or individual's BrokerCheck[®]⁷⁴ report.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

⁷² See Statistics on Unpaid Customer Awards in FINRA Arbitration, <http://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration>. FINRA updates these data periodically.

⁷³ See Member Firms and Associated Persons with Unpaid Customer Arbitration Awards, <http://www.finra.org/arbitration-and-mediation/members-firms-and-associated-persons-unpaid-customer-arbitration-awards>. FINRA updates these data periodically.

⁷⁴ FINRA developed and operates this free tool under the oversight of the SEC to provide investors with information regarding a broker's employment history, regulatory actions, investment-related licensing information, arbitrations and complaints. See BrokerCheck[®], <https://brokercheck.finra.org>.

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2019-027 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2019-027. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2019-027 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷⁵

Jill M. Peterson
Assistant Secretary

⁷⁵ 17 CFR 200.30-3(a)(12).

Exhibit 5

Below is the text of the proposed rule change. Proposed new language is underlined; deletions are in brackets.

* * * * *

BY-LAWS OF FINRA REGULATION, INC.

ARTICLE I DEFINITIONS

* * * * *

When used in these By-Laws, unless the context otherwise requires, the term:

(a) through (q) No Change.

(r) “FINRA member” means any broker or dealer admitted to membership in FINRA. For purposes of the Code of Arbitration Procedure for Customer Disputes or the Code of Arbitration Procedure for Industry Disputes, FINRA member[s] includes any broker or dealer admitted to membership in FINRA whether or not the membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from FINRA, or the member is otherwise defunct; and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code of Arbitration Procedure for Customer Disputes or the Code of Arbitration Procedure for Industry Disputes and[/or] to be treated as members of FINRA for purposes of the Codes of Arbitration Procedure, whether or not [the] its membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from its self-regulatory organization, or the member is otherwise defunct;

(s) through (kk) No Change.

* * * * *

FINRA Rules

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12000. CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES

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12100. Definitions

Unless otherwise defined in the Code, terms used in the [Rules] Code and interpretive material, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws.

(a) No Change.

(b) Associated Person

The term "associated person" or "associated person of a member" means a person associated with a member, as that term is defined in paragraph ([u]w).

(c) through (p) No Change.

(q) Inactive Member

The term "inactive member" means a member as defined in paragraph (s) of this rule:

(1) whose membership is terminated, suspended, cancelled or revoked;

(2) that has been expelled or barred from FINRA; or

(3) that is otherwise defunct.

(r) Inactive Associated Person

The term "inactive associated person" means a person associated with a member as defined in paragraph (w) of this rule whose registration is revoked, cancelled, or

suspended, who has been expelled or barred from FINRA, or whose registration has been terminated for a minimum of 365 days.

([q]s) Member

For purposes of the Code, the term "member" means any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from FINRA, or the member is otherwise defunct; and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code and [/or] to be treated as members of FINRA for purposes of the Code, whether or not [the] its membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from its self-regulatory organization, or the member is otherwise defunct.

([r]t) Non-Public Arbitrator

The term "non-public arbitrator" means a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator under paragraph ([y]aa).

([s]u) Panel

No Change.

([t]y) Party Portal

No Change.

([u]w) Person Associated with a Member

The term "person associated with a member" means:

- (1) No Change

(2) A sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not:

(A) [a]Any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA; or

(B) Any such person's registration is revoked, cancelled, or suspended, the person has been expelled or barred from FINRA, or the person's registration has been terminated for a minimum of 365 days.

For purposes of the Code, a person formerly associated with a member is a person associated with a member.

([v][x]) Pleadings

No Change.

([w][y]) Prehearing Conference

No Change.

([x][z]) Pro Se

No Change.

([y][aa]) Public Arbitrator

The term "public arbitrator" means a person who is otherwise qualified to serve as an arbitrator, and is not disqualified from service as an arbitrator, as enumerated by any of the criteria below.

Permanent Disqualifications Based on a Person's Own Activities

(1) No Change.

(2) A person shall not be designated as a public arbitrator, who was, for a total of 15 years or more, an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional time annually, to any entities listed in paragraph ([y]aa)(1) [and/]or to any persons or entities associated with any of the entities listed in paragraph ([y]aa)(1).

(3) through (4) No Change.

Temporary Disqualifications Based on a Person's Own Activities

(5) No Change.

(6) A person shall not be designated as a public arbitrator who is an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional time, in any single calendar year, to any entities listed in paragraph ([y]aa)(1) [and/]or to any persons or entities associated with any of the entities listed in paragraph ([y]aa)(1) unless the calendar year ended more than five calendar years ago.

(7) through (8) No Change.

Temporary Disqualifications Based on the Activities of Others at a Person's Employer

(9) A person shall not be designated as a public arbitrator who is an attorney, accountant, or other professional whose firm derived \$50,000 or more, or at least 10 percent of its annual revenue, in any single calendar year during the course of the past two calendar years, from any entities listed in paragraph

([y]aa)(1) [and/]or to any persons or entities associated with any of the entities listed in paragraph ([y]aa)(1), or from a bank or other financial institution where persons effect transactions in securities including government or municipal securities, commodities, futures, or options. A person whom FINRA would not designate as a public arbitrator under this subparagraph shall also not be designated as a public arbitrator for two calendar years after ending employment at the firm.

(10) No Change.

Temporary Disqualification Based on the Financial Industry

Affiliation of an Immediate Family Member

(11) No Change.

For purposes of the public arbitrator definition, the term "revenue" shall not include mediation fees received by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

([z]bb) Respondent

No Change.

([aa]cc) Statement of Claim

No Change.

([bb]dd) Submission Agreement

No Change.

([cc]ee) Third Party Claim

No Change.

* * * * *

12202. Claims Against Inactive Members and Inactive Associated Persons

(a) A claim by or against a member or an associated person [in one of the following categories] who is inactive at the time the claim is filed is ineligible for arbitration under the Code unless the customer agrees in writing to arbitrate after the claim arises.]:

- A member whose membership is terminated, suspended, cancelled or revoked;
- A member that has been expelled from FINRA; or
- A member that is otherwise defunct.]

(b) If a member or an associated person becomes inactive during a pending arbitration, FINRA will notify the customer about the status change. Within 60 days of receiving notice of a member or an associated person's status change to inactive, a customer may withdraw the claim(s) against such inactive member or inactive associated person with or without prejudice.

* * * * *

12214. Payment of Arbitrators

(a) Except as provided in paragraph (b) and in Rule 12800, FINRA will pay the panel an honorarium, as follows:

(1) through (3) No Change.

(4) \$600 for each arbitrator if a hearing session other than a prehearing conference is postponed within 10 days before a scheduled hearing session pursuant to Rules 12601(a)(1)(B), (a)(2) and (b)(2); and

(5) No Change.

(b) through (d) No Change.

* * * * *

12309. Amending Pleadings

(a) No Change.

(b) After Panel Appointment

Once a panel has been appointed, a party may [only] amend a pleading:

(1) if the panel grants a motion to amend in accordance with Rule 12503.

Motions to amend a pleading must include a copy of the proposed amended pleading. If the panel grants the motion to amend, the amended pleading does not need to be re-served on the other parties, the Director, or the panel, unless the panel determines otherwise[.]; or

(2) if FINRA notifies a customer that a member or an associated person has become inactive as set forth in Rule 12202. The customer may amend a pleading within 60 days of receiving notice. The customer must serve the amended pleading on each party and file the amended pleading with the Director.

(c) Amendments to Add Parties

Once the ranked arbitrator lists are due to the Director under Rule 12402(d) or Rule 12403(c), [no] a party may only amend a pleading to add a new party to the arbitration if:

(1) [until] a panel has been appointed and the panel grants a motion to add the party. Motions to add a party after panel appointment must be served on all parties, including the party to be added. The party seeking to amend the pleading

may serve the party to be added by first-class mail, overnight mail service, overnight delivery service, hand delivery, email or facsimile. Service by first-class mail or overnight mail service is accomplished on the date of mailing. Service by any other means is accomplished on the date of delivery. The party to be added may respond to the motion in accordance with Rule 12503 without waiving any rights or objections under the Code. The response may be filed with the Director and served on all other parties by first-class mail, overnight mail service, overnight delivery service, hand delivery, email or facsimile [.] or

(2) FINRA notifies a customer that a member or an associated person has become inactive as set forth in Rule 12202. The customer may amend a pleading to add a new party to the arbitration within 60 days of receiving notice. The customer may serve the party to be added by first-class mail, overnight mail service, overnight delivery service, hand delivery, email or facsimile. Service by first-class mail or overnight mail service is accomplished on the date of mailing. Service by any other means is accomplished on the date of delivery. The customer must serve the amended pleading on each other party and file the amended pleading with the Director.

(d) No Change.

* * * * *

12400. Neutral List Selection System and Arbitrator Rosters

(a) No Change.

(b) Arbitrator Rosters

FINRA maintains the following roster of arbitrators:

- (1) A roster of non-public arbitrators as defined in Rule 12100([r]t);
- (2) A roster of public arbitrators as defined in Rule 12100([y]aa); and
- (3) No Change.

(c) No Change.

* * * * *

12601. Postponement of Hearings

(a) Postponement of Hearings

(1) When a Hearing Shall Be Postponed

A hearing shall be postponed:

(A) by agreement of the parties[.]; or

(B) if FINRA notifies a customer that a member or an associated person has become inactive as set forth in Rule 12202, the scheduled hearing date is within 60 days of the date the customer receives the notice from FINRA, and the customer chooses to postpone the hearing date.

(2) When a Hearing May Be Postponed

A hearing may be postponed:

[•](A) By the Director, in extraordinary circumstances;

[•](B) By the panel, in its own discretion; or

[•](C) By the panel, upon motion of a party.

The panel may not grant a motion to postpone a hearing made within 10 days of the date that the hearing is scheduled to begin, unless the panel determines that good cause exists.

(b) Postponement Fees

(1) through (2) No Change.

(3) No postponement fee will be charged if a hearing is postponed:

[•](A) Because the parties agree to submit the matter to mediation administered through FINRA, except that the parties shall pay the additional fees described in Rule 12601(b)(2) for late postponement requests;

[•](B) By the panel in its own discretion; or

[•](C) By the Director in extraordinary circumstances.

(4) No postponement fee under Rule 12601(b)(1) or additional fee of \$600 per arbitrator under Rule 12601(b)(2) will be charged if a customer postpones a hearing under Rule 12601(a)(1)(B).

(c) No Change.

* * * * *

12702. Withdrawal of Claims

(a) No Change.

(b) After a claim has been answered by a party, the claimant may only withdraw [it] the claim against that party with prejudice unless:

(1) the panel decides otherwise;

(2) [, or] the claimant and that party agree[,] otherwise; or [.]

(3) a customer filed a claim and the party that answered the claim is a member or an associated person that became inactive, as set forth in Rule 12202, during a pending arbitration.

* * * * *

12801. Default Proceedings

(a) Applicability of Rule

A claimant may request default proceedings against any respondent that falls within one of the following categories and fails to file an answer within the time provided by the Code:

- (1) A member whose membership has been terminated, suspended, canceled, or revoked;
- (2) A member that has been expelled or barred from [the] FINRA;
- (3) A member that is otherwise defunct; or
- (4) An associated person whose registration is [terminated,] revoked, cancelled, or suspended, who has been expelled or barred from FINRA, or whose registration has been terminated, regardless of the number of days since termination.

(b) through (f) No Change.

* * * * *

12900. Fees Due When a Claim Is Filed

(a) through (b) No Change.

(c) Partial Refund of Filing Fee

(1) If a claim is settled or withdrawn more than 10 days before the date that the hearing on the merits under Rule 12600 is scheduled to begin, a party paying a filing fee will receive a partial refund of the filing fee in the amount indicated in the schedule below, less any other fees or costs assessed against the

party under the Code, including any hearing session fees assessed under Rule 12902. [No] Except as set forth in Rule 12900(c)(3), no refund will be paid if FINRA receives notice that a claim is settled or withdrawn within 10 days of the date that the hearing on the merits under Rule 12600 is scheduled to begin.

Partial Refund for Settlement or Withdrawal

More Than 10 Days Before Hearing on the Merits

Amount of Claim (exclusive of interest and expenses)	Refund
\$.01 to \$1,000	\$25
\$1,000.01 to \$2,500	\$50
\$2,500.01 to \$5,000	\$125
\$5,000.01 to \$10,000	\$250
\$10,000.01 to \$25,000	\$300
\$25,000.01 to \$50,000	\$450
\$50,000.01 to \$100,000	\$750
\$100,000.01 to \$500,000	\$1,125
\$500,000.01 to \$1,000,000	\$1,300
\$1,000,000.01 to \$5,000,000	\$1,400
Over \$5,000,000	\$1,500

Non-Monetary/Not specified	\$1,200
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(2) No Change.

(3) If FINRA notifies a customer that a member or an associated person has become inactive during a pending arbitration, as set forth in Rule 12202(c), and the customer withdraws the claim(s) against such member or associated person within the 60-day time period specified in the rule, FINRA will remit a full refund per the schedule in Rule 12900(a) to the customer even if the customer withdraws the claim(s) within 10 days of the date that the hearing on the merits under Rule 12600 is scheduled to begin.

(d) No Change.

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13000. CODE OF ARBITRATION PROCEDURE FOR INDUSTRY DISPUTES

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13100. Definitions

Unless otherwise defined in the Code, terms used in the Code and interpretive material, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws.

(a) through (p) No Change.

(q) Member

For purposes of the Code, the term “member” means any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from FINRA

or the member is otherwise defunct; and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code and[/or] to be treated as members of FINRA for purposes of the Code, whether or not [the] its membership has been terminated, [or] suspended, cancelled, revoked, the member has been expelled or barred from its self-regulatory organization, or the member is otherwise defunct.

(r) through (ee) No Change.

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